S. HRG. 99-716

# THE INTERLOCKING DIRECTORATE ACT OF 1986

## HEARING

OF THE

## COMMITTEE ON THE JUDICIARY
## UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

## S. 2163

A BILL TO MAKE NECESSARY AND APPROPRIATE AMENDMENTS TO THE ANTITRUST LAWS GOVERNING SERVICE AS A DIRECTOR OF COMPETING CORPORATIONS

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APRIL 28, 1986

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# THE INTERLOCKING DIRECTORATE ACT OF 1986—S. 2163

MONDAY, APRIL 28, 1986

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
*Washington, DC.*

The committee met, pursuant to notice, at 9:38 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Metzenbaum and Grassley.

Staff present: Ken Starling, chief antitrust counsel.

## OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The CHAIRMAN. The committee will come to order.

The committee is meeting today to continue a series of hearings on the five bills that I recently introduced on behalf of the administration to reform antitrust law and procedures.

Today, the subject of our hearing is section 8 of the Clayton Act, which governs the membership of corporate boards of directors. The concern of section 8 is that individuals might serve on the boards of directors of competing corporations and act as a communications link between the two corporations in ways that reduce competition. A board member may have access to secret or confidential information which, if shared with other firms, might lessen competition between the firms.

Section 8 was enacted in 1914, and it acts as a flat prohibition. It does, however, contain a firm-size threshold, below which concern about the suppression of competition is insignificant. That cutoff has not been updated since 1914, and the administration, joined by many others who have considered this issue, recommends that the statute be modernized.

The purpose of this effort is to preserve the application of section 8 where there is a realistic and substantial threat to competition, but to allow capable individuals to serve multiple corporations as directors where their service will not cause any significant antitrust problems.

We have a group of witnesses who have considerable experience with these issues. First, we have Douglas Ginsburg, head of the Antitrust Division of the Justice Department. Then we will receive a report from the American Bar Association, presented by Mr. James Halverson, who is the chairman of the ABA's section of antitrust law. After Mr. Halverson, we will hear the views of a panel of witnesses who represent boards of directors.

I should note that we also invited the Acting Chairman of the Federal Trade Commission, who has responsibility for enforcement of section 8. He could not be with us this morning, but will give us his views at a later time.

Before I call the first witness I wish to place a copy of S. 2163 in the record.

[Text of S. 2163 follows:]

II

99TH CONGRESS
2D SESSION

# S. 2163

To make necessary and appropriate amendments to the antitrust laws governing service as a director of competing corporations.

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IN THE SENATE OF THE UNITED STATES

MARCH 7 (legislative day, FEBRUARY 24), 1986

Mr. THURMOND (for himself, Mr. LAXALT, Mr. HATCH, Mr. EAST, Mr. MCCONNELL, and Mr. MURKOWSKI) (by request) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

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# A BILL

To make necessary and appropriate amendments to the antitrust laws governing service as a director of competing corporations.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That this Act may be cited as the "Interlocking Directorate Act of 1986".

SEC. 2. The fourth paragraph of section 8 of the Clayton Act (15 U.S.C. 19) is amended by—

(a) striking out "any one" and inserting in lieu thereof "each";

(b) striking out "$1,000,000" and inserting in lieu thereof "$10,000,000";

(c) striking out the period after "laws" and inserting in lieu thereof the following: ": *Provided*, That service as a director in two or more corporations shall not be prohibited by this section if the sales, determined on the basis of annual average gross revenues over the preceding two completed calendar or fiscal years, as may be appropriate in the circumstances, of each such corporation of each product or service sold by such corporations in competition with one another (1) are less than 5 percent of such corporation's total sales, unless the sales of all such products or services by such corporation exceed 25 percent of such corporation's total sales; (2) together with such corporation's sales of all other such products or services are less than $1,000,000; or (3) are less than 3 percent of the total sales in each line of commerce in each section of the country in which such corporations compete."; and

(d) adding at the end the following: "For each fiscal year commencing after September 30, 1986, the $10,000,000 and $1,000,000 thresholds in this paragraph shall be increased as of October 1 each year by an amount equal to the percentage increase in the gross national product, as published by the Department

of Commerce or its successor, for the year then ended over the level so established for the year ending September 30, 1985.".

○

The CHAIRMAN. Our first witness this morning is Mr. Douglas H. Ginsburg, Assistant Attorney General, Antitrust Division.

Mr. Ginsburg, we are very pleased to have you with us, and you may now proceed.

**STATEMENT OF HON. DOUGLAS H. GINSBURG, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, DC**

Mr. GINSBURG. Thank you very much, Mr. Chairman.

With your permission, I will submit a written statement for the record and briefly summarize orally.

As you know, Senate bill 2163 would update the interlocking directorate provision, section 8 of the Clayton Act, in light of circumstances that have evolved since 1914.

The origins of section 8 and the underpinnings of section 8 are wellknown to the committee. This proposal originated in both the Republican and Democratic platforms in 1912, and was signed into law in 1914. This administration reaffirms the view held by every administration since then that it is important that interlocking directorates be limited and that they be tolerated only in circumstances where they pose no threat to competition.

In the years since 1914, however, it has become evident that the jurisdictional threshold for coverage of section 8 needs to be raised from the $1 million limit that was written in 1914 to something that more realistically reflects current dollar levels, and that a de minimis exception needs to be incorporated into the law in order to eliminate its unintended effects on the availability of directors for corporations.

The administration's bill introduces the de minimis concept through three very specific approaches relating to a de minimis level of sales in competing products by the firms involved, a de minimis market share in the products concerned, and a de minimis percentage of the firm's sales such as to make it unlikely that the product line in question would become a subject of attention of the board of directors.

These three concepts are, I think, each very efficient ways of getting at the de minimis problem because they are readily quantifiable, and in two of the three cases, the firm has the data it needs in its own records to determine whether it qualifies for the "safe harbor"—that is, of course, the percentage of sales and the dollar volume of sales.

With that little introduction, Mr. Chairman, perhaps we can turn to such questions as you and the committee may have about the bill.

I would be happy to answer any of your questions.

[The prepared statement follows:]

[1]

STATEMENT OF

DOUGLAS H. GINSBURG
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

Mr. Chairman and Members of the Committee:

I am pleased to have the opportunity to appear before the Committee today to testify on behalf of S. 2163, the "Interlocking Directorate Act of 1986." This bill removes unnecessary restrictions on the ability of American businesses to obtain the best qualified corporate directors. S. 2163 is one of several bills, introduced by the Chairman on behalf of the Administration, that will modernize and improve the antitrust laws. I want to express again our thanks to the Committee for scheduling this hearing and the prior hearings on the Administration's antitrust remedies and merger proposals so quickly. The Administration's antitrust reform legislative package contains timely and important improvements that fully warrant the prompt attention the Committee is giving to them.

S. 2163 amends section 8 of the Clayton Act. Enacted in 1914, section 8 prohibits a director of any firm that has capital, surplus, and undivided profits of more than $1 million from also serving as a director of any other firm if the firms are "by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the provisions of the antitrust laws." Section 8 is a purely prophylactic statute: its prohibition applies without any showing that a director interlock either has had or is likely to have adverse effects on competition.

The interlock prohibition in section 8 is relatively clear-cut. Clarity in a statute is to be preferred, of course, but a very clear and broad prophylactic provision that requires no showing of actual harm can come to restrict potentially beneficial activities that do not threaten to bring about the

harm that the statute was intended to prevent. This is exactly what has happened to section 8, and what S. 2163 is intended to remedy.

The major problem presented by section 8 is its apparent prohibition of interlocks between firms that technically may be viewed as competitors, but that actually compete only to a de minimis extent. Firms large enough to be covered by section 8 are often widely diversified, producing or selling a wide variety of products and services, including many that are generally unrelated to their primary lines. Strict interpretations of section 8 that do not recognize any de minimis exceptions to its prohibitions 1/--and these are not unreasonable interpretations given section 8's current language--prevent an individual from serving as a director of two corporations engaged principally in different businesses whenever such corporations also happen to sell even minimal amounts of competing products.

There is no good reason for so broad and literal a prohibition of director interlocks between corporations that are only incidentally competitors. De minimis overlaps involving sales that are miniscule as compared to each firm's overall business or to total sales in the relevant market, or in absolute dollar amount, do not present a plausible competitive threat that would warrant such a prohibition. Moreover, this prohibition is hindering the ability of firms to obtain the best directors they can: extremely capable and willing director candidates all too often are being disqualified after counsel's discovery of a de minimis competitive overlap. In short, section 8's prohibition of interlocks involving de minimis overlaps is serving no public purpose whatever, but is causing unnecessary frustration and hardship to private enterprise. This also impedes companies from increasing the number of outside directors they have.

1/ See, e.g., TRW v. Federal Trade Commission, 647 F.2d 942, 948 (9th Cir. 1981); In re Borg-Warner Corp., 3 Trade Reg. Rep. (CCH) ¶ 22,049 (F.T.C. June 23, 1983), rev'd on other grounds, 746 F.2d 108 (2d. Cir. 1984).

S. 2163 solves this problem by creating three specific "safe harbor" exceptions in section 8 for de minimis overlaps. The first safe harbor allows interlocks among firms each of whose sales of any competing product are less than 5 percent of its total sales. The rationale of this exception is the common sense proposition that boards of directors focus their deliberations on businesses that generate substantial portions of their firms' revenues. The second allows interlocks where the total competitive overlap amounts to less than $1,000,000 of each firm's business; this figure is indexed to the Gross National Product so that it will not become outdated. Interlocks involving such small amounts of commerce simply do not warrant a broad federal prophylactic prohibition. The third safe harbor allows interlocks among firms each of whose sales of any competing product are less than 3 percent of the relevant market. Harm caused by a director interlock between firms with such small market shares is inherently implausible, because buyers simply would turn to other sellers if the interlocked firms raised prices in concert. These exceptions will make it much easier for firms to select well-qualified directors where there are minor competitive overlaps but no real possibility of competitive harm.

An alternative to spelling out specific safe harbor exceptions would be simply to add a generally worded de minimis exception to section 8. We carefully considered this alternative, but believe that greater certainty as to the lawfulness of service as a director is important to firms and director candidates alike. It is hard to know how courts would interpret a general de minimis standard, except that they would inevitably differ among themselves. By contrast, the explicit, numerical safe harbor exceptions in S. 2163 will enable corporations and their potential directors to know in advance whether an interlock would be illegal. The percent-of-total-sales and absolute-dollar exceptions are based on the firms'

readily available sales records; the percent-of-relevant-market safe harbor involves a figure most firms could estimate with reasonable confidence. Thus, we believe that S. 2163 is the better approach to the de minimis problem in section 8.

S. 2163 also updates the jurisdictional size-of-firm threshold in section 8. In 1914, Congress limited the coverage of section 8 to interlocks between two or more corporations any one of which had capital, surplus, and undivided profits of more than $1,000,000. One million dollars today is not what it was 70 years ago; thus, section 8 has become considerably more restrictive than it was ever intended to be. S. 2163 corrects this situation by raising the jurisdictional threshold to $10,000,000. It also prevents that figure from becoming outdated again by indexing it to the Gross National Product. Finally, the bill frees small businesses from federal oversight of the make-up of their boards by requiring both interlocked firms to exceed the jurisdictional threshold, rather than just one, as is currently required by section 8.

To summarize, Mr. Chairman, S. 2163 would not disturb section 8's basic prophylactic prohibition of director interlocks between substantial competitors. Rather, it makes necessary and appropriate housekeeping amendments to section 8 by eliminating its literal coverage of interlocks where there is only a de minimis overlap and by updating its jurisdictional criteria. We urge favorable consideration of S. 2163 by the Committee.

Mr. Chairman, this concludes my prepared remarks. I would be happy to address any questions the Committee may have.

U.S. Department of Justice

Antitrust Division

*Office of the Assistant Attorney General* *Washington, D.C. 20530*

MAY 22 1986

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am glad to have this opportunity to respond to Senator Specter's questions, enclosed with your letter of April 28, 1986, concerning my testimony on S. 2163, the "Interlocking Directorate Act of 1986." My answers are as follows:

Q.1. Section 8 of the Clayton Act prohibits any person from serving as a director of competing corporations engaged in interstate commerce if any of the corporations has capital, surplus, and undivided profits of more than $1,000,000. S. 2163 raises this dollar threshold to $10,000,000. What is the Department's position regarding this increase in the threshold amount?

A. The current $1 million size-of-firm threshold was enacted in 1914 in order to limit the coverage of section 8 to reasonably large firms. That figure has remained unchanged for 72 years. Thus, section 8 is now considerably more restrictive than Congress ever intended and sweeps far more broadly than is necessary. The Department believes that the threshold figure should be increased to $10 million. In addition, we propose that section 8 be amended to prohibit interlocks only where both companies involved exceed the size-of-firm threshold. Because section 8 currently applies if either firm exceeds the threshold, it prevents a person from sitting on the board of a large firm and a small firm simultaneously if the firms have a competitive overlap. This puts the potential director to an election that is likely to favor the large firm. Together, these changes will remove unwarranted government oversight of

the activities of small and emerging companies whose choices for their boards of directors are unlikely to have anticompetitive effects.

Q.2. Existing case law is inconsistent as to whether there is a de minimis exception to Section 8, (See, e.g., Paramount Pictures Corp. v. Baldwin-Montrose Chem. Co., 1966 Trade Cas. (CCH) ¶ 71,678 (S.D.N.Y. 1966); In re Borg-Warner Corp., 101 F.T.C. 863 (1983), rev'd on other grounds, 746 F.2d 108 (2d Cir. 1984). What is the Department's view on whether a de minimis exception should exist?

A. The Department is persuaded that Congress should provide a de minimis exception to section 8. In the absence of a de minimis exception, no one may serve as a director of two diversified corporations that compete with one another, no matter how insignificant the competitive overlap. The sole purpose of the statute is to prevent anticompetitive director interlocks. Where the likelihood of anticompetitive harm is extremely remote, as is the case where competitive overlaps are de minimis, a bar on interlocking directors restricts the ability of American corporations to obtain the advice of the most able directors available without providing any countervailing benefits.

* * *

I hope my answers to these questions will assist the Committee in its deliberations on S. 2163. Please let me know if I can be of any further assistance.

Sincerely,

Douglas H. Ginsburg
Assistant Attorney General

The CHAIRMAN. I am going to ask you the same question I am going to ask the panelists. One of the safe harbors contained in the administration proposal would allow director interlocks between companies that compete in a line of business and their sales in that line of business do not constitute more than 5 percent of their total sales. This would seem to allow interlocks between very large corporations that might have substantial shares of a market, so long as their sales in that market do not exceed 5 percent of the corporation's total sales.

In your view, is this appropriate, or should the bill be refined to limit the market shares of firms that are permitted to have interlocking directorates?

Mr. GINSBURG. Mr. Chairman, the rationale for this safe harbor is that the boards of directors of companies large enough to be covered by section 8 as we would amend it would not typically concern themselves with activities that account for such a small share of the corporation's business.

Now, I think it necessary to acknowledge that reasonable people can disagree as to whether 5 percent is the threshold for board of directors' attention, or whether some greater or lesser number represents an accurate threshold.

My conversations with corporate counsel suggest to me that this is a reasonable approximation of the threshold for getting a board's attention.

I think the concern over the particular metes and bounds of this safe harbor, the particular threshold that is chosen, is far less important than the principle that a safe harbor be provided based on a percentage of sales. I would be happy to discuss with the committee any other number that may come to mind, but I think the principle is terribly important.

The CHAIRMAN. Thank you.

The able and distinguished Senator from Ohio.

Senator METZENBAUM. Thank you, Mr. Chairman.

Mr. Attorney General, I must be frank with you. I am at this meeting without my top staff man. I think you have given us so much aggravation on the antitrust laws that he is in the hospital with an ulcer—or maybe I have given him so much trouble—but be that as it may, he cannot be with us this morning, but I think he is going to be all right.

And I must say to you that I am not really totally geared in as to what the present law is, what the provisions are, and what you are proposing. I can read the legislation, but I would like you to spell it out, if you would, and then I have some questions that will lead from there.

Mr. GINSBURG. Senator Metzenbaum, the baseline legal rule against which this proposal is emerging is one that essentially prohibits two firms from having a common director if there is any competition between the two firms, regardless of how insignificant that competition is as a percentage of the market in which it operates, or as a percentage of the firms' sales, or as a matter of dollar volume.

I think you will hear examples from other witnesses today, suggesting the ludicrous lengths to which this can act to bar a board from having among its members a director who serves on another

board because the two companies, although they may have billions of dollars in sales each, have only a few hundred thousand dollars or a few million dollars in sales in the same product market. Such overlaps would be likely to have no competitive significance.

Senator METZENBAUM. You say there is a strict proscription, a total proscription.

Mr. GINSBURG. There is a per se prophylactic rule, Senator, yes. And while that has been subject to debate and to some doubt, I think there are at least one or two circuit court opinions and a recent FTC opinion affirming that it is a per se rule.

Senator METZENBAUM. Now, then, your first amendment strikes out "any one" and inserts in lieu thereof "each". I do not have the law in front of me; staff has not been able to provide me with it. Could you give me the significance of that?

Mr. GINSBURG. Yes, Senator. Currently, the law would prohibit an interlock—assuming there is any competition between the two firms—if either of the firms has capital, essentially net worth, in excess of $1 million, regardless of how small the other firm is. We would provide that each firm must meet the jurisdictional threshold, which we also propose to change to $10 million.

Senator METZENBAUM. $10 million total sales?

Mr. GINSBURG. Not sales, sir; capital, net worth.

The significance of the change is essentially this. Currently, the proscription operates to prevent a person from sitting on the board of a large firm and of a small firm simultaneously if they meet the competitive overlap criterion. That will almost always put the potential director to an election which will end up favoring the large firm. If he has to choose to sit on one board or the other, it will tend to be the larger firm.

Senator METZENBAUM. Let us go back—I thought it was sales; you tell me it is net worth. Frankly, I do not think net worth is nearly as relevent as sales, because I could very well imagine a company that had a very small net worth that had been suffering economic distress, that was hurting, that its net worth was down to $7 million, but it was selling 40 million dollars' worth of product, and another company that was selling 70 million dollars' worth of product.

I must say this whole subject is not something I have dealt with, except I do have some other aspects of it that I have dealt with, but I will not talk to you about those. Wouldn't it be better to use sales as the determinant, rather than net worth, whatever that figure might be—$1 million, $5 million, $10 million, whatever the case may be? It seems to me that would be much more logical, if you are talking about changing the law; isn't this the time to change that as well?

Mr. GINSBURG. Senator, I am using net worth as, I think, a permissible shorthand for the statutory phrase, which is "capital, surplus, and undivided profits." With that clarified, let us continue to call it "net worth."

Now, I think——

Senator METZENBAUM. Wait a minute, wait a minute.

Mr. GINSBURG. Yes, sir?

Senator METZENBAUM. "Capital surplus and undivided profits" does not take into account the company's actual capital. Let us

assume the company was capitalized at $20 million—I do not even know the phrase "capital surplus" as such.

Mr. GINSBURG. Senator, it is "capital," comma, "surplus," comma "and undivided profits."

Senator METZENBAUM. Oh, "capital," comma, "surplus," comma, and what else?

Mr. GINSBURG. "And undivided profits."

Senator METZENBAUM. OK.

Mr. GINSBURG. That can be fairly equated as the paid-in capital, the retained earnings, and the——

Senator METZENBAUM. Year's profits.

Mr. GINSBURG [continuing]. And the year's profits less liabilities. So that translates to assets less liabilities, which we can fairly abbreviate as net worth.

Senator METZENBAUM. Now, my question to you is, is that really the right criterion to use, or shouldn't the criterion be just sales? Because that is really what we are talking about, is impact on the marketplace.

Mr. GINSBURG. Senator, the particular criterion that is represented in the 1914 version is, as you suggest, more appropriate for some industries than for others. But that turns out to be true for any alternative, as well.

We looked at not only net worth, but at asset size, at sales, and so on, and across industries there is no one clearly superior measure, because these ratios differ so much by industry. Capital-intensive industries may have a very high ratio of investment to sales. As you undoubtedly know, some industries are very highly leveraged, and because debt reduces net worth, that can distort the actual picture.

But rather than try to differentiate industry by industry, we ended up, in our proposal, essentially seeing the wisdom of the drafters in 1914. It is now a standard with which there is a great deal of experience, and it does not seem to have caused significant problems, so we have not proposed to change it.

Senator METZENBAUM. If the committee were to decide that they wanted to use the sales factor, or perhaps the sales factor plus the capital factor, would that be a major concern to you?

Mr. GINSBURG. Senator, I would have to return to my economists and see what sort of effect such a factor would have across industries, in order to see whether it would be anomalous.

Senator METZENBAUM. At first blush, I think that is a much more significant factor than is net worth, and I think that I would want to discuss that with my colleagues on this committee. I think it is more meaningful.

But now go on to the next part of the bill, because up until this point you have just been talking about net worth or sales, and then starting on line 3 of page 2, you get into the proviso, which I gather is the "safe harbor" language.

Mr. GINSBURG. Yes, Senator. There are three safe harbors provided in the bill. One is itself geared to sales, somewhat along the line you are suggesting, but the provision there would simply say if the sales that are in competition between the two firms that propose the interlock are less than $1 million on each side—that is to say,

for each firm—then the safe harbor should apply. That is the second of the three provisos.

Senator METZENBAUM. The sales figure?

Mr. GINSBURG. That is a sales figure, yes.

The first of the three safe harbors is the 5 percent of sales test to which the chairman referred in his question.

Senator METZENBAUM. Let me see, now. I am just looking at the statute, which I now have before me. The only million dollars that I see mentioned in the statute has again to do with "capital, surplus, and undivided profits". Am I reading it at the wrong place?

Mr. GINSBURG. That is the current law, Senator.

Senator METZENBAUM. That is the current law?

Mr. GINSBURG. Yes. Are you looking at the bill?

Senator METZENBAUM. Now I am looking at both the law and the bill. In the law, in line 1, you strike out "$1 million" and insert in lieu thereof "$10 million".

Mr. GINSBURG. Yes.

Senator METZENBAUM. But that refers to "capital, surplus, and undivided profits."

Mr. GINSBURG. Yes. That is the jurisdictional threshold so that only firms above that level are covered by section 8.

Of course, in 1914 there were not very many firms that had more than $1 million in net worth. Today, there are, we think, 5,300 publicly traded firms above that size and an unknown number of privately held firms.

Senator METZENBAUM. Then vou strike out after the word "laws" in the fourth paragraph and you put in your proviso. Now, will you address yourself to the proviso?

Mr. GINSBURG. Yes. The proviso establishes three quantitative safe harbors, so that even if both of the firms that propose to have a common director are subject to section 8, they may have the common director if they meet any one of these three tests.

All of the tests relate to the amount of competition between the two companies in question.

The first test would simply say that if the competition constitutes in any product line less than 5 percent of each company's sales, then it can be disregarded—the theory being that if it is such a small matter, it will not command the attention of the board of directors.

On the other hand, if there were a large number of products, each of which was less than 5 percent of a firm's sales, but that cumulatively constituted a large percentage of the firm's sales, conceivably it could be a matter of attention for the board of directors, and so we have proposed a cap of 25 percent for all competing products.

If I can take an example, then, Senator——

Senator METZENBAUM. I understand.

Mr. GINSBURG. You have it; thank you.

The second safe harbor is the flat $1 million for each firm. If the competing sales are less than $1 million, the overlap may be disregarded. Now, for a firm that has $10 million or more in net worth, that is truly a de minimis portion of its sales.

The third safe harbor is for an interlock where each firm accounts for less than 3 percent of the relevant market. In an inter-

lock between two firms, the maximum share of the market that could be implicated in the interlock would be 6 percent, which would not be a threat to competitive performance in that market.

Beyond raising the jurisdictional threshold, applying it to both firms, or all firms, that are party to an interlock, and establishing three safe harbors, the bill would index the dollar amounts that are found in the statute.

Senator METZENBAUM. What would you do in the case that the law does not now cover? Let us assume that a member of the Chase-Manhattan Bank is also a member of Exxon and Mobil, or any other oil company. There was much concern about that some years past of making that director a conduit between the corporations; they could not talk to each other, but through the director, they could. What are your thoughts on that subject?

Mr. GINSBURG. If I might restate that to make sure I understand it. A representative of the Chase Bank sits on the boards of two competing oil companies, in your hypothetical?

Senator METZENBAUM. You could do it that way, or you could have a member of the board of each of the companies also sitting on the board of Chase-Manhattan; you could put various configurations.

Mr GINSBURG. Yes. Those are so-called indirect interlocks where the common board is not one of the two competitors, but could constitute either a conduit or a meeting place for their representatives. That sort of interlock has never been prohibited by section 8; as indicated in your statement, that is why it was a matter of some concern once, in recent years.

A study that I believe the FTC did of a large number of major companies revealed that indirect interlocks are fairly common. We have not seen an indirect interlock as a problem in any actual antitrust case that has arisen, to my knowledge, however.

Senator METZENBAUM. It is pretty hard to find evidence of its having an impact. You are talking about one man, two people, whatever it may be. It is pretty difficult for that kind of evidence to become available—even though it may or may not have been a factor. But the fact is that director, sitting on that bank board, or whatever else he may be sitting on—he may be sitting on an investment banking firm's board; he may be sitting on a supplier's board—there can be these combinations. And the question that I have is don't we have some obligation? If we are trying to make some improvements in the law now, aren't there some other aspects and issues that we ought to give our attention to? I wonder whether or not the Antitrust Division would be receptive to trying to work this legislation around in such a way that it not only loosens up in some respects in accordance with present economic facts, but also provides some realistic approach to the Chase-Manhattan situation—and of course, I only use that bank as an example. What would be your attitude about that?

Mr. GINSBURG. Senator, parenthetically, and perhaps for the record, I should mention that I was once a lawyer for the Chase Bank, and I am recused on all matters affecting the Chase Bank.

Senator METZENBAUM. Well, then, let us make it Bank of America.

Mr. GINSBURG. But this is hypothetical. Bank of America is fine.

I think, Senator, in the absence of any indication that there is a competitive problem with such interlocks, we should be very hesitant to intervene. I think there is a good explanation, other than the one you have offered, for the apparent lack of competitive problem. That explanation is that director liability under State law has become a very significant deterrent to activity that blatantly poses a potential conflict of interest.

The situation in your hypothetical suggests a director who, sitting on the boards of two major competitors, would find it extremely difficult to avoid actual liability for his decisions.

Senator METZENBAUM. You missed my point. I am not worried about the conflict of interest between his representing one oil company as against another. I am concerned about his being in a position to see to it that both oil companies work together against the public's interests.

Mr. GINSBURG. I understand, Senator. What I am suggesting is that because of the potential for liability, one will rarely find the situation that you have just hypothesized, that is, the bank director sitting on those two major competitors' boards.

Now, the bank may have different representatives sitting on different boards that are in competition with each other, and may do so specifically in order to avoid anyone individual being put in that conflict position. But to think that constitutes an anticompetitive threat is to hypothesize a conspiracy that now involves multiple representatives of the bank in question as well as members of the boards of the two competing firms.

Senator METZENBAUM. I do not think it is quite that complicated, but I am not going to delay this hearing. I would say to you that I think I am going to look at that subject and see whether or not we cannot draft some language that perhaps should have been in the law a long time ago on that issue.

I see this legislation as being the kind of legislation that is not earth shaking, is not absolutely necessary; maybe it helps a little bit some who are concerned about these issues. But I think that if we are going to loosen it up in some respects—and I am interested in the sales aspect as distinguished from the capital worth aspect—then I think that we also have to take a look at whether the law needs tightening along some other lines. And I am aware of the fact that getting anything to tighten up antitrust laws through this administration is like climbing up the mountain to the Moon. Notwithstanding that, there are some of us in Congress who do believe that antitrust is good for the free enterprise system.

Mr. GINSBURG. Senator, if I might comment just briefly, since the time this statute was enacted in 1914, of course, violation of the Sherman Act has been raised from a misdemeanor to a felony. I think it is important to bear in mind that this prophylactic rule which isolates boards and prevents common directors now operates to make it difficult for boards to get directors on the premise that those directors will take the occasion, or may take the occasion, to commit a felony, presumably in the company of their colleagues on the board.

While we believe the prophylactic rule is still appropriate, we think that there is no risk to competition in engrafting these de minimis exceptions.

Senator METZENBAUM. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Ginsburg, could you summarize what you regard as the main benefits of making the proposed changes in section 8 of the Clayton Act?

Mr. GINSBURG. Yes, Senator

Currently, section 8 prevents the larger corporations in the United States from obtaining the services of many of the potential directors that they would like to have on their boards, and does so without conferring any particular benefit on the competitive process or the protection of the public. This has become a virtually standard problem for the general counsels and CEO's of larger firms in the United States, and the examples that I have been made aware of indicate that it imposes a cost on the system with no offsetting benefit.

There is a good deal of value placed on having outside directors. The Securities and Exchange Commission and many State corporation laws see the value of that. At the same time, increases in directors' and officers' liability insurance and the prohibition found in section 8 make it increasingly difficult to find capable directors for these positions. We think we should alleviate that difficulty, if we can do so without sacrificing our interest in a competitive economy.

The CHAIRMAN. Thank you very much.

Senator METZENBAUM. Who initiated this effort?

Mr. GINSBURG. I am sorry, Senator.

Senator METZENBAUM. Who intiated this move, this legislation? Is this coming from the Department, the American Bar Association?

Mr. GINSBURG. I suggested to the working group last fall, the Administration Working Group on Antitrust Reform, that we try to redress some of the problems in section 8. I did so on the basis of a series of complaints that I had heard from corporate counsel. I was not then knowledgeable about the situation, but have since dug into it, and the working group agreed to include it in the package.

Senator METZENBAUM. Thank you

The CHAIRMAN. Thank you very much.

Now, we will ask the panel to come to the table, and Mr. Halverson, I am going to ask you to join this panel, if you will, in behalf of the American Bar Association.

Mr. Pogue, from Jones, Day, Reavis & Pogue; Mr. Coyle, the vice president and general counsel and secretary of TRW, and Mr. Charles Tausche, on behalf of the U.S. Chamber of Commerce, if you will all have a seat, please.

Senator METZENBAUM. It is very thoughtful of you, Mr. Chairman, and probably recognizing the quality, that 40 percent of our witnesses today come from Cleveland. I think you get the message.

The CHAIRMAN. Well, maybe they will have a little influence on you, Senator. [Laughter.]

Senator METZENBAUM. If I can say, I know that they are both great supporters of mine, politically, so I am sure that they will; I mean, they are some of my staunchest allies.

The CHAIRMAN. Mr. Halverson, could you take about 5 minutes and give us the thrust of your statement? If you have a full written

statement, we will put it in the record, but just give us the thrust of what you have to say in about 5 minutes.

**STATEMENT OF A PANEL, INCLUDING: JAMES T. HALVERSON, SHEARMAN & STERLING, NEW YORK, NY, ON BEHALF OF THE AMERICAN BAR ASSOCIATION, SECTION ON ANTITRUST LAW; RICHARD W. POGUE, MANAGING PARTNER, JONES, DAY, REAVIS & POGUE, CLEVELAND, OH; MARTIN A. COYLE, VICE PRESIDENT, GENERAL COUNSEL AND SECRETARY, TRW, INC., CLEVELAND, OH; AND CHARLES TAUSCHE, ANTITRUST COUNSEL, SEARS, ROEBUCK & CO., CHICAGO, IL, ON BEHALF OF U.S. CHAMBER OF COMMERCE, COUNCIL ON ANTITRUST POLICY**

Mr. HALVERSON. Yes, thank you, Mr. Chairman.

I am chairman of the section of antitrust law of the American Bar Association and appear here today on behalf of the American Bar Association and have been designated by William W. Falsgraf, also from Cleveland, OH, who is the present president of the American Bar Association, to be the association's representative at today's hearing.

In February of this year, the ABA's house of delegates approved as official American Bar Association policy a resolution which urges Congress to amend section 8 of the Clayton Act by increasing the $1 million jurisdictional threshold which was mentioned by Mr. Ginsburg, and by allowing certain de minimis safe harbors.

The resolution, which is designated as report No. 306, Mr. Chairman, is attached to my testimony which I have asked to have incorporated in the record.

Subsequently, the administration proposed, and you, Mr. Chairman, introduced S. 2163, the proposed Interlocking Directorate Act of 1986, which embodies the administration proposal.

Since S. 2163 embodies proposals very similar to those in the ABA report, and since the proposals in the ABA report actually go further than those contained in S. 2163 in terms of the de minimis exception areas, the American Bar Association is pleased to express its support for enactment of S. 2163, with a few changes that I would suggest.

I will not spend time going into the background of the enactment of section 8; Mr. Ginsburg has done so very eloquently. I might add, though, that recent profiles of management behavior suggest that the instances in which one person controls corporate destinies by personal force are rare in present-day corporate America, and we have strong legal proscriptions which prevent a director from violating a conflict of interest.

The common law has developed more fully to protect against these abuses; the law on fiduciary duties has moved in the direction of becoming more protective of the shareholder and minority interests. The Federal securities laws, State corporate laws, and common law theories of fiduciary duty would seem adequate to deter most conflicts of interest or breaches of fiduciary duty.

Finally, while boards of directors have ultimate decisionmaking power, usually lower level employees in fact make day-to-day pricing, product development, and marketing decisions, thus making collusion unlikely through an interlocking directorate situation.

We also have a situation today where it is very difficult, particularly for large corporations who are seeking outside directors, to get those directors in the face of a per se statute—section 8—under which irrespective of the amount of commerce involved or the amount of sales involved, if there is any overlap of sales, those directors are hesitant to go on the boards of two competing corporations.

This diminishes the corporation's opportunity to obtain the services of qualified directors and in turn also diminishes directorship opportunities for qualified potential directors and compels these corporations to forego the benefits of obtaining and retaining a valuable individual as a board member.

I might say I am a corporate counselor and have been involved in counseling a great number of corporations in this area, and because of the lack of a de minimis standard, I have had to counsel several corporations and prospective directors about the risks of a possible de minimis overlap, even though a very small amount of competition is involved. This causes a director to face potential liability under section 8, and hence, leads directors to decline to serve on boards for that reason.

Senator METZENBAUM. Mr. Halverson, would you comment on the point that I was raising with Mr. Ginsburg, concerning the sales factor rather than capital?

Mr. HALVERSON. Well, Senator Metzenbaum, the ABA proposal on the threshold jurisdictional amount, which is the net worth proposal, is identical to the administration's. This again we took out of the language of existing section 8. Our safe harbors are different, but the ABA proposal on the threshold amount is identical.

As to sales, I guess I would have to stay, as an ABA representative, within the ABA's proposal, because that is what I am authorized to say.

My personal view is I would not mind seeing it changed to sales.

Senator METZENBAUM. Thank you.

Mr. HALVERSON. Let me turn to the two proposals, because they do differ. Section 8 prohibits a person from serving as a director of competing corporations where any of the corporations has capital, surplus, and undivided profits, so-called net worth, aggregating more than $1 million.

That is a very old threshold going back to 1914. The administration has proposed raising that to $10 million, and the American Bar Association has also proposed raising that to $10 million, so both S. 2163 and ABA report No. 306 agree on that.

On the safe harbor de minimis exceptions, the administration has proposed three—the 5 percent of a corporation's total sales rule; the $1 million corporation sales of products or services in the competing area rule; and the 3 percent of total sales in each line of commerce in which the corporations compete rule.

The de minimis standards set by the ABA were: Sales volume of either corporation for each product or service does not exceed $25 million—in other words, we did not have a percent-of-sales rule; we had a $25 million rule for sales of each such product or service for either corporation—or the aggregate sales of each such product or service of all the corporations which share a common director, and

this could be one, two, or three, constitute 10 percent or less of the sales of such product or service and competing products or services.

So in the administration's proposal, where you have less than 3 percent of the total sales in each line of commerce in each section of the country in which such corporations compete involved, we would have less than 10 percent of the sales by all sellers of such products involved.

Of course, in the administration's proposal, if you had two interlocking corporations, as explained by Mr. Ginsburg, you could have 6 percent and so on. We have put a cap on it at 10 percent.

Senator METZENBAUM. One of the things that concerns me is that you men all deal in the world of high finance, top corporate operations. And the ABA lawyers pretty much, I would say not exclusively, but to a great extent, think along those lines.

I am sitting here thinking about two automobile dealers who want to work together on pricing, but know that they cannot do that; two bottling companies in a local area who want to work together, Pepsi-Cola and Coca-Cola; two TV distributors or small manufacturers. What concerns me is that, as you start getting these numbers up, that you open the door to a kind of price fixing that will be impossible for anybody to prove, probably, but it does open the door wider.

I know that that is not normally done, but as I sit here, I am thinking about it, and I know that we have legislation, as you know, to provide an antitrust exemption for the beverage distributors right now. And I think that it would not take genius of a lawyer to figure out that that would be a good way that they could work together without actually strictly violating the antitrust laws.

Give me your thoughts on this question of the smaller companies.

Mr. HALVERSON. First I would say, Senator Metzenbaum, that the typical Pepsi-Cola or Coca-Cola bottler would have some significant problems here, because some of them are very, very large corporations. We are talking about $250 million, $500 million, and so on.

Senator METZENBAUM. Do not hold me to that. Figure out your own example.

Mr. HALVERSON. All right. On the smaller corporation, I must say that we do now rely in the main on the Sherman Act and the felony prohibitions that Mr. Ginsburg talked about to prohibit discussions of price or marketing or production.

Senator METZENBAUM. But if you have the same director in both companies, then he does not really have to be involved in pricing.

Let me take Mansfield, OH, instead of New York City, for the pop distributors, or some smaller community where they do not have $250 million in volume—there are lots of small ones around, and there are opportunities for price fixing in those areas.

Mr. HALVERSON. I cannot deny that opportunities for price fixing exist, Senator, and I would agree that they do. But this does not change the felony nature of what those people would be doing in small company situations.

And what I am saying, and what Mr. Ginsburg has said, is it helps those 5,000 corporations which, because of section 8 and the many fiduciary duties imposed by the Securities Act, interpreta-

tions of the Securities Act, and modern interpretations of State law, the corporations are having a very difficult time finding outside directors which they very badly need to police the affairs of the corporation.

Senator METZENBAUM. At a certain point this week, next week, or last week, there will be representatives coming before us and telling us the whole problem about getting directors has to do with the ability to obtain liability insurance; that will be the main thrust. Now you are saying that this is really the reason?

Mr. HALVERSON. I am not saying section 8 is the sole reason. I am saying that this is one of the very significant reasons. Those of us who counsel here—Mr. Pogue is next to me here; both of us do—those of us who counsel on the area counsel very often that it is a very significant risk for a corporate director to go on another board, even though the overlap is very, very insignificant.

Senator METZENBAUM. I am not arguing that $1 million is the right figure. I am not sure that net worth is the right factor, and I think that we may be able to structure some language that is liveable that is better than it is and maybe does not let down the bars as far as some of you would advocate that we do.

Mr. HALVERSON. Thank you.

The CHAIRMAN. Thank you, Mr. Halverson.

[The prepared statement follows:]

STATEMENT

of

JAMES T. HALVERSON, CHAIRMAN

SECTION OF ANTITRUST LAW

AMERICAN BAR ASSOCIATION

before the

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

IN SUPPORT OF

S. 2163, THE PROPOSED "INTERLOCKING DIRECTORATE ACT OF 1986"

April 28, 1986

Mr. Chairman and members of the Committee, my name is James T. Halverson, and I am Chairman of the Section of Antitrust Law of the American Bar Association. I am appearing today on behalf of the American Bar Association, and have been designated by William W. Falsgraf, President of the ABA, to be the Association's representative at today's hearing.

In February of this year, the ABA's House of Delegates approved as official ABA policy a resolution which urges Congress to amend § 8 of the Clayton Act by increasing the $1,000,000 jurisdictional threshold and by allowing, in certain defined situations, interlocking directorates among corporations engaged in de minimis levels of competition with each other. The resolution (designated "Report No. 306") is attached as Appendix A of this statement. Subsequently, the Administration proposed, and Senator Thurmond introduced, S. 2163, the proposed "Interlocking Directorate Act of 1986," which embodies proposals similar to those in the ABA report. Since the proposals in the ABA report actually go farther than those contained in S. 2163, the ABA is pleased to express its support for enactment of this legislation, with a few changes I will outline.

Background

Section 8 of the Clayton Act prohibits any person from acting as a director of two or more competing corporations, if any one of those corporations has combined capital, surplus and undivided profits exceeding one million dollars. Section 8 was passed in 1914 amidst an emotional climate of reform. The statute was part of President Woodrow Wilson's program to resolve a problem that had been highlighted by Louis Brandeis in a series of Harper's Weekly articles./1 Brandeis charged that the anticompetitive, self-serving designs of a group which he labelled "the money trust" or the "inner group" were being perpetrated through the vehicle of interlocking directorates among large corporations./2 While President Wilson feared the group's potential to endanger economic freedom,/3 Brandeis was concerned specifically with the competitive abuses and conflict of interest problems arising from interlocking directorates./4

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1. See Brandeis, Breaking the Money Trusts, Harper's Weekly, Nov. 22, 1913, at 10; id., Nov. 29, 1913, at 9; id., Dec 6, 1913, at 13; id., Dec 13, 1913, at 10; id., Dec 20, 1913, at 10; id., Dec 27, 1913, at 18; id., Jan. 3, 1914, at 11; id., Jan. 10, 1914, at 18; id., Jan. 17, 1914, at 18.

2. See id., Dec 6, 1913, at 13-15, where Brandeis concluded that interlocking directorates were "the most potent instrument of the Money Trust." Id. at 13.

3. See H.R. Rep. No. 627, 63d Cong., 2d Sess. 18 (1914).

4. See Brandeis, supra note 1, Dec. 6, 1913, at 13-15.

Earlier congressional investigations provided precedent and support for the warnings sounded by Wilson and Brandeis. As early as 1887, the Pettison Report/5 had revealed significant abuses in railroad construction, lease, and repair contracts, allegedly attributable to four Central Pacific Railroad Company directors who also controlled the corporations which were parties to the contracts with Central Pacific./6 Subsequently, the Pujo Committee/7 and the Stanley Committee/8 disclosed instances in which anticompetitive practices were implemented through the mechanism of interlocking directorates. These latter two reports in particular helped to create the atmosphere of reform in which Section 8 of the Clayton Act was enacted. They outlined the extent to which major banks, manufacturing and industrial corporations, railroads, insurance companies and public utilities were interlocked by common directors./9

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5. Pacific Railway Commission, S. Exec. Doc. No. 51, 50th Cong., 1st Sess. (1887).

6. Id., Vol 1, at 143.

7. House Comm. on Banking and Currency, Investigation of Concentration of Control of Money and Credit, H.R. Rep. No. 1593, 62d Cong., 3d Sess. (1913).

8. House Comm. on Banking and Currency, Investigation of United States Steel Corp., H.R. Rep. No. 1127, 62d Cong., 1st Sess. (1912).

9. ABA Antitrust Section, Monograph No. 10, Interlocking Directorates Under Section 8 of the Clayton Act (1984) (hereinafter ABA Monograph No. 10), at 3.

Section 8 was thus enacted at a time when it was widely believed that one person could effectively control the affairs of many companies and that a director simultaneously sitting on the boards of competing entities would necessarily be able to bring about anticompetitive effects in the market./10 Today, however, years of experience and learning seem to rebut this assumption./11

Recent profiles of management behavior suggest that instances in which one person controls corporate destinies by personal force are rare in present-day corporate America, as strong legal, economic and peer pressures carefully circumscribe the powers of any one director./12 Unquestionably, since the enactment of Section 8 in 1914, directors and the companies they direct have become subject to an increasing number of laws and regulations designed to prevent the abuses found by the Stanley and Pujo Committees./13 In addition, the common law has developed more fully to protect against such abuses. For example, the law on fiduciary duties has moved in the direction of becoming more protective of

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10. In fact, even before the enactment of the Clayton Act, but after much public debate on the subject, J.P. Morgan, Jr., George F. Baker, and several other prominent financiers announced their withdrawal from the directorships of dozens of large corporations.

11. See generally Mace, Directors: Myth and Reality - Ten Years Later, 32 Rutgers L. Rev. 293 (1979).

12. ABA Monograph No. 10, at 24-27.

13. Examples are the Securities Exchange Act of 1934, the Securities Act of 1933, and, for banks, the Glass-Steagall Act.

stockholder and minority interests. Thus, the prospect of liability under the federal securities laws, state corporate laws or common law theories of fiduciary duty would seem adequate to deter most conflicts of interest or breaches of fiduciary duty./14 Finally, it can be argued that while boards of directors have ultimate decision making power, lower level employees in fact make the day-to-day pricing, product development and marketing decisions, thus making collusion through interlocking directors unlikely.

Section 8 is a so-called "per se" statute. That is, the mere existence of competition is sufficient to trigger Section 8's sanctions, without regard to the amount of commerce that might be involved. This approach was first enunciated in the seminal case, United States v. Sears, Roebuck, Inc., 111 F. Supp. 614 (S.D.N.Y. 1953), and subsequent courts have continued to adopt the per se standard as the appropriate one in determining the legality of an interlock under Section 8. However, the typical scope of the businesses engaged in by corporations and the role of corporate directors have broadened dramatically since Section 8's enactment in 1914./15 If a per se rule ceases to reflect the realities of the problem it was designed to solve, then it should be reexamined to ensure that it does not become harmful to the very public it is supposed to serve. In the

14. ABA Monograph No. 10, at 25.

15. Furthermore, Section 8 of the Clayton Act was enacted contemporaneously with the merger statute, Section 7 of the Clayton Act, and was intended to supplement the Sherman Act of 1890. Analysis under Section 7 and under the Sherman Act (ftnt. 15 cont. on p. 6)

past 70 years, corporations have become increasingly diversified and subject to international competition. As a consequence, it is much more likely now for diversified corporations to compete in lines of commerce that are not significant to either corporation. Because the per se standard continues to apply to the use of common directors by competing corporations in de minimis overlap situations, the corporation are being hindered in obtaining the services of qualified directors. This in turn also diminishes directorship opportunities for qualified potential directors and compels corporations to forego the benefits of obtaining or retaining a valuable individual as a board member.

Similarly, the role of outside directors in corporate governance has changed since 1914. In recent years, the responsibilities of directors have increased significantly and they have been encouraged to take a more active role in management of the company. Such outside directors act as important advisors to management and trustees of the shareholders' interests. In addition, they assist and broadly guide the corporation from an independent standpoint not shared by inside directors.

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(ftnt. 15 cont.) must be based on and reflect competitive realities. Although a per se standard applies to certain practices with clear anticompetitive effects, rule of reason analysis has increasingly been required by the courts. See, e.g., Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co., 53 U.S.L.W. 4733 (June 11, 1985). It would be anomalous to apply a per se standard of liability to interlocking directorates when the whole trend of antitrust law is to abandon the shortcut, non-analytical per se standard.

At the same time, the pool of individuals available to serve on boards of directors is diminishing as persons who traditionally might have served have become more hesitant to do so in view of potential liability and other problems./16 Individuals on the margins of the law's scope have for some years been expressing concern about accepting positions on corporate boards where the existence of competitive overlap is merely de minimis. Because of the lack of a de minimis standard, I have had to counsel several corporations and prospective directors about the risks of overlapping directorates if even a small amount of competition exists between the firms. Indeed, a national business publication reported as long as ten years ago that "U.S. corporations face a worsening problem as they try to fill seats on their boards of directors."/17

The continuing furor over corporate behavior suggests that the role of outside directors in corporate affairs will increase. Boards can be expected to become even more involved in developing corporate policy and in generating ideas, as well as more vigilant in ensuring that management's conduct is lawful. The greater responsibilities to be assumed by outside directors demand that interlock regulation and enforcement be sensible. The realities of

16. See Sloate, Outside Corporate Directors: Will Increasing Liability Send Them Running Out of Board Rooms?, 48 N.Y.St. B.J. 618,619 (1976) and Halverson, Should Interlocking Director Relationships be Subject to Regulation and, If So, What Kind?, 45 Antitrust L.J. 341 (1976).

17. Business Week, Mar. 29, 1976, at 100.

today's corporate world require that interlock regulation not be so severe as to diminish further the pool of qualified individuals who are willing to serve as outside directors. As indicated, the law governing fiduciary responsibility of directors, federal securities law disclosure requirements, and state law director conflict of interest statutes, by themselves, would probably catch most, if not all, of the abuses Section 8 was enacted to prevent.

Thus, a de minimis exception to the statute is long overdue. In 1976 I gave a talk suggesting several approaches which could be applied to Section 8./18 One of those approaches was to require the meeting of a "significant competitive overlap" test before a director would be banned from sitting on the boards of any two companies. This proposal would have outlawed interlocks only where the horizontal competitive overlap between the companies involved a product line which was a significant part of the business of each in a geographic market in which they both competed. Thus, the significant competitive overlap test would look to the existence of actual and significant competition within the relevant market prior to declaring an interlock unlawful. That is the objective of the de minimis standards proposed in both the ABA's Report No. 306 and S. 2163.

The adoption of objective de minimis standards would serve the public interest because compliance with Section 8

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18. Halverson, note 16 supra.

is enhanced by internal corporate programs to monitor directorships their directors may accept. However, this self-policing, to be effective, requires a realistic and clear standard. At present, it is unclear whether Section 8 prohibits an interlocking directorate when competition between corporations is de minimis. For example, Paramount Pictures Corp. v. Baldwin-Montrose Chem. Co.,/19 a 1966 case from the Southern District of New York, recognized a de minimis defense, but in the recent Borg-Warner case, the FTC concluded that Section 8 does not contain a de minimis exception./20 And in In re Hughes Tool Co.,/21 the FTC fashioned a consent order prohibiting future interlocks when the competing lines of both companies equal or exceed $5 million. The Working Group on Antitrust Review has concluded that "under a strict reading of the statute, interlocks are forbidden even if the competition between them is de minimis."/22

Because the Clayton Act does not clearly provide an exception for de minimis competition, antitrust counselors face a dilemma. They can advise their clients that any

19. 1966 Trade Cas. (CCH) ¶ 77,678 (S.D.N.Y. 1966).

20. In re Borg Warner Corp., 3 Trade Reg. Rep. (CCH) ¶ 22,049 (FTC 1983), rev'd on other grounds, 746 F. 2d 108 (2d Cir. 1984).

21. FTC Dkt. No. 9183 (Jan. 16, 1984).

22. Memorandum for the Domestic Policy Council From the Working Group on Antitrust Review on Proposed Changes in the Antitrust Laws, reprinted in 49 Antitrust & Trade Reg. Rep. (BNA), 946 at 950 (Nov. 28, 1985).

degree of competition, no matter how trivial, may trigger Section 8 liability, thus eliminating or discouraging qualified individuals from service as outside directors on a corporation's board. Alternatively, they can counsel that technical application of the law is unlikely, but with no certainty that their clients will not be exposed to liability for violating Section 8. The Federal Trade Commission has been asked to consider promulgating guidelines embodying a de minimis standard, but the FTC has not indicated an interest in doing so.

Corporations, as well as their officers and directors, attempt in good faith to comply with Section 8 of the Clayton Act and should not be ensnared by technical breaches of the statute without clear guidelines as to what overlaps are permitted. Section 8 should be modernized by increasing the $1,000,000 jurisdictional threshold and by enacting de minimis standards. Amendment of Section 8 to incorporate de minimis standards would serve the public interest by recognizing present-day business realities, eliminating the anomaly of declaring behavior unlawful without consideration of its effects on competition, and, as mentioned supra, maximizing the benefits of self-policing. At the same time, legislative adoption of de minimis standards would not diminish the usefulness of the statute to protect competition from the potential harm that might result from interlocks where there are significant competitive overlaps.

Jurisdictional Threshold

Section 8 prohibits a person from serving as a director of competing corporations where any of the corporations has capital, surplus, and undivided profits aggregating more than $1,000,000. This jurisdictional threshold is now more than seventy years old and obviously brings within the ambit of the statute businesses too small by modern standards to have any significant impact on the economy. The statute should be amended to increase the threshold amount to $10,000,000 and to provide that the prohibition of Section 8 applies only where each of the corporations involved in the interlocks meets the threshold test. In addition, the jurisdictional amount should be indexed to a recognized measure of inflation to avoid its becoming obsolete.

Both S. 2163 and ABA Report No. 306 provide for these changes.

"Safe Harbor" De Minimis Exceptions

Report No. 306 recommends that Section 8 be amended to provide that service as a director shall not be prohibited if the sales by competing corporations of any competing products or services are de minimis. Those sales would be presumed to be de minimis if:

> (1) sales volume per annum of either corporation for each such product or service does not exceed $25,000,000, or
>
> (2) if the aggregate sales of each such product or service by all of the corporations which share a common director constitute ten percent or less of the sales by all sellers of such product or service and competing products or services.

S. 2163 would allow interlocking directorates if the sales of competing products or services by each corporation:

> (1) are less than five percent of such corporation's total sales, unless the sales of all such products or services by such corporation exceed 25 percent of such corporation's total sales; [or]
>
> (2) together with such corporation's sales of all other such products or services are less than $1,000,000; or
>
> (3) are less than three percent of the total sales in each line of commerce in each section of the country in which such corporations compete.

The ABA proposal establishes a presumption that a competitive overlap involving $25 million or less in sales by either corporation, or aggregate sales by the interlocking corporation of ten percent or less of a relevant market, is de minimis and therefore lawful. This would provide objective guidance to directors and their counsel while permitting law enforcement agencies to show that competitive overlaps should be prohibited where circumstances warrant.

Obviously, S. 2163 does not go this far. Its safe harbor provisions would exempt only aggregate single-firm sales of competing products or services of $1,000,000, as opposed to $25,000,000, and would exempt overlaps of only 3% of the relevant market rather than 10% of the relevant market. Thus, the American Bar Association proposes that the safe harbor provisions of S. 2163 be extended to encompass the provisions of Report No. 306.

However, if such extentions are not made, the American Bar Association would still look favorably on the

passage of S. 2163, as reform in this area is much-needed, and the safe harbors provided, while not in our minds expansive enough, would be preferable to the present system.

Provision of Indexing for Inflation

There is a further difference between S. 2163 and Report No. 306. S. 2163 proposes that the $10,000,000 and $1,000,000 thresholds be increased each year by an amount equal to the percentage increase in the Gross National Product (GNP), whereas Report No. 306 recommends that the dollar amounts contained in Section 8 be indexed to the Consumer Price Index (CPI) to safeguard against the effects of inflation. The Gross National Product is a more conservative and slower-moving measure of inflation than is the Consumer Price Index. The American Bar Association has expressed its preference for the latter, and therefore recommends that S. 2163's index be changed from the GNP to the CPI.

Conclusion

With the exceptions that I have noted, the American Bar Association thus recommends passage of S. 2163. For the information of the Committee, a fine treatment of the subject of interlocking directorates is found in ABA Antitrust Section, Monograph No. 10, Interlocking Directorates Under Section 8 of the Clayton Act (1984).

Mr. Chairman, I thank you for the opportunity to present the views of the American Bar Association on this matter.

APPENDIX A

REPORT NO. 306

BE IT RESOLVED by the American Bar Association that the congress be urged to amend Section 8 of the Clayton Act relating to interlocking directorates to add provisions which would:

(1) Create a de minimis exception where either of the corporations involved has capital, surplus and undivided profits of $10 million or less; or

(2) Create a de minimis exception where sales of the product or service with regard to which corporations are in competition are $25 million per annum or less for either corporation; or the aggregate sales of the product or service with regard to which the corporations are in competition constitute 10 percent or less of the sales of the product or service and competing products and services by all sellers; and

(3) Provide that the dollar amounts of sales contained in Section 8 be indexed to the Consumer Price Index.

The CHAIRMAN. Mr. Pogue, you may take a few minutes now and give us the thrust of your statement.

## STATEMENT OF RICHARD W. POGUE

Mr. POGUE. Thank you, Mr. Chairman.

I have submitted a written statement, but I would like to touch on a few points.

The CHAIRMAN. Would you like your written statement to go in the record?

Mr. POGUE. Yes, sir.

The CHAIRMAN. Without objection, that will be done.

Mr. POGUE. Thank you, sir.

I believe that S. 2163 is very salutory legislation which is necessary in order to correct certain misstatements which were made in a court opinion in a case which was decided in 1981 in the ninth circuit. That case involved TRW. TRW won the case, but unfortunately, there was some dictum in the opinion of the court which indicated that there is no de minimis defense under section 8. I believe that that was a great shock to all of those who have practiced in this field for many, many years, because prior court opinions had indicated that there was a de minimis defense, and many of us had relied upon those prior opinions.

After the ninth circuit opinion in 1981, a number of companies were very concerned about it for the reasons that Messrs. Ginsburg and Halverson have testified to, and an effort was made principally through myself initially, and later through other lawyers as well, to interest the Federal Trade Commission in issuing some prosecutorial discretion guidelines. We asked the Commission if they would say perhaps the ninth circuit is correct, but we are going to be practical and exercise some common sense in deciding with which of these de minimis board membership issues we will be concerned with.

I personally visited all of the Commissioners at that time, and all of them were sympathetic to that idea that it was necessary to correct the ninth circuit unfortunate dictum. However, they were concerned that the statute itself does not contain an express de minimis exception, and therefore over these years since 1981, the Commission has been unable to reach a judgment that it was prepared to promulgate some guidelines.

Senator METZENBAUM. Would you tell us about the de minimis language. You just mentioned it, but I do not understand.

Mr. POGUE. Well, until the 1981 decision in *TRW* in the ninth circuit, several courts had indicated that section 8 was not intended by Congress to deal with trivial or de minimis situations. And everyone in the field had relied on those earlier opinions. When the ninth circuit came along and said there is no de minimis defense, it was in effect saying section 8 is an absolute prohibition on any directorship overlap where there are competing sales. And the commissioners in the *Borg-Warner* opinion of the Federal Trade Commission, if you read it carefully, through all the footnotes and concurrences, and so forth, each one of them recognized the merit of issuing guidelines in this area to permit de minimis exceptions. But the Commission felt that since the statute did not specifically

except de minimis situations, it would defer until Congress had an opportunity to correct this situation.

Senator METZENBAUM. Mr. Pogue, would it give you any problem if we used the sales figure instead of the net worth figure? I have asked Mr. Halverson, and he said he could live with it, but he was not speaking for the ABA.

Mr. POGUE. The way I look at that, Senator Metzenbaum, is that this is a specific problem; this de minimis issue is a specific problem that needs to be corrected, and the sooner the better.

I think that the de minimus issue is an isolated problem; I think it is not a controversial problem. I have not heard of anyone who is basically opposed to the concept of correcting this error. And I hate to get the legislation caught up in a lot of other issues. The net worth standard for the threshold has been in there since 1914; everybody is used to it. What the administration is saying is let us recognize that there has been inflation since then and tinker with the statute as little in that regard as possible.

On the other hand——

Senator METZENBAUM. They are tinkering a hell of a lot with it by putting the whole safe harbor provision in. I mean, if you just want to change the statute, then you go from $1 million to $5 million or $10 million or $50 million, whatever the case. But this is real tinkering. This is a major change in providing a safe harbor.

Now, are you saying that is necessary in order to deal with the de minimis issue?

Mr. POGUE. Yes, sir. I am saying that this unfortunate court language in *TRW*, which was not necessary to the decision, has created a great confusion in the field, and therefore Congress should, in effect, return the situation to where it was prior to the *TRW* decision.

Senator METZENBAUM. Well, I think you would agree that the three safe harbor decisions go a lot further than need be in order to achieve the objective about which you are speaking. The one concerning the victum in that one case.

Mr. POGUE. Well, they are discussing what the specific scope of each safe harbor provision should be; and obviously, there are many different proposals that have been put on the table. But I do not think that anybody disagrees that there should be some safe harbor provisions enacted.

As far as net worth versus sales go—with respect to the threshold issue as opposed to the safe harbor issue, I do not regard that as a major controversial issue. I think that the benefit of the administration's bill on this point is that they have proposed to retain a standard in the threshold area that everyone has been accustomed to.

Senator METZENBAUM. Well, I will say to you and I will say to the others that I think this is the kind of legislation that does not demand a lot of attention; there is not a great sense of excitement that we have to do this, with the various other items that we have on our agenda. And I think it would serve all parties' purposes best if we could figure out a way to work out some language that would make it move, as Senator Thurmond and I did with the Antitrust Procedural Improvements Act some years ago. Otherwise, I think we are going to get into some rather lengthy discussions, both in

committee and on the floor of the Senate, and I do not know what will happen in the House.

But I would say that the door is open to talk about what can work, what will work, and what does not go further than is necessary in order to achieve the objective that you seek.

Mr. POGUE. Thank you, sir. I think that that would be ideal, because, as I said before, this is an isolated problem that has been caused by one court opinion. The other types of issues that you referred to earlier in your questioning of the prior witnesses would entangle this specific issue in a lot of unnecessary considerations.

[The prepared statement follows:]

TESTIMONY

OF

RICHARD W. POGUE

Mr. Chairman and Members of the Judiciary Committee.

My name is Richard W. Pogue. I am the Managing Partner of Jones, Day, Reavis & Pogue, the second largest law firm in the country with 10 offices in various cities across the country and overseas. I appreciate the opportunity to appear before you today to express my support for S. 2163, the Interlocking Directorate Act of 1986.

I have spent 29 years in active antitrust law practice with Jones Day. During this period I have litigated, counseled, written and spoken extensively in the antitrust field. I am a past Chairman of the Section of Antitrust Law of the American Bar Association. I have defended Directors and their companies against several complaints filed by the government under Section 8 of the Clayton Act, and have represented many other Directors and their companies in governmental investigations under Section 8 or in Section 8 counseling matters. I have also served as a Director of a number of corporations.

For several years I have been a principal advocate before the Federal Trade Commission of flexible prosecutorial guidelines in the Section 8 context. In particular, in September 1981, I wrote a letter to the then-Acting Chairman of the Federal Trade Commission, David A. Clanton, urging the Federal Trade Commission to issue guidelines clarifying the Commission's intentions regarding enforcement of Section 8 of the Clayton Act. I am attaching a copy of that letter to my testimony today. The principal matter that I urged the Federal Trade Commission to address was the need to recognize an

exception to the statute where competition between two corporations is trivial or de minimis. As I will explain shortly, I firmly believe that Section 8, especially as it has been interpreted in several recent decisions (e.g., TRW Inc. v. F.T.C., 647 F.2d 942 (9th Cir. 1981), and Borg-Warner Corp., F.T.C. Docket No. 9120 (1983) (order vacated on other grounds, 746 F.2d 108 (2d Cir. 1984)), is a harmful statute that has made it difficult for companies to attract qualified, experienced Directors. In my view, the effect of these narrow, rigid interpretations has been to convert the statute into a regulatory burden that effectively prohibits certain common Directorships even where there is no realistic potential that any anticompetitive conduct would occur as a result.

My September 1981 letter prompted other letters from the private bar also urging the Federal Trade Commission to issue prosecutorial guidelines addressing the scope of the de minimis exemption and other aspects of Section 8. The desirability of legislative recognition of a de minimis exemption has specifically been addressed in a recent Report of the Council of the Antitrust Section of the American Bar Association and in a November 1985 Memorandum to the Domestic Policy Council and the Economic Policy Council from the Working Group on Antitrust Review.

I have also remained active on this matter. In particular, I have discussed the de minimis issue on a number of occasions over the past several years with the Federal Trade Commission and members of its staff, as well as with other government officials and members of the private bar. Further, several of my clients have constantly urged me to continue my efforts to obtain either administrative or legislative recognition of a de minimis exemption under Section 8. Based on these discussions and my other activities in this area, it is my perception that there currently exists strong support for legislation that would temper the harmful effects of Section 8. I agree that Congress should act in this area.

I will divide my remarks today into two parts. First, I would like to address some of the policy reasons why I believe it is necessary to amend Section 8 to address the de minimis issue. Next, I will turn to the specific bill that is before you today, S. 2163.

Today, this country's corporations face strong and increased competition both from other domestic firms and from foreign firms. In recent years Congress has recognized these competitive realities and in several instances has sought to ensure in recent legislation that domestic firms are not unnecessarily hampered in their efforts to compete in the marketplace. (See, for example, the Export Trading Company Act of 1982 and the National Cooperative Research Act of 1984.) This is certainly a desirable goal especially in an era of trade imbalances and at a time when this Administration and the Congress have stated their concerns about unnecessary regulatory burdens. S. 2163 is an effort to continue this laudable trend.

As I stated at the outset of my remarks, Section 8 as it exists today is a burdensome regulatory statute. As it is being interpreted, it seems to be dealing with certain perceived abuses that are almost assuredly not likely to occur today. Let me briefly summarize the expansive nature of Section 8 that has created this unfortunate situation.

As you know, Section 8 is designed to minimize the likelihood that two corporations, through the device of a common Director on their respective Boards, might engage in horizontal collusion such as price fixing or market or territorial allocation. Recent interpretations suggest that the statute prohibits any individual from serving as a Director of two corporations if the two corporations compete to any degree, no matter how trivial or miniscule the extent of the competitive overlap. Indeed, under these interpretations it appears that a common Directorship is prohibited even if the overlap between the two corporations is as little as tens of thousands of dollars or even several million dollars in a product market that has hundreds of millions of dollars of total sales. I am sure

that the inside counsel who are testifying before you today can attest to the specific difficulties that they have encountered as the result of the expansive nature of Section 8. These difficulties confirm that a statute that in today's complex economy precludes common Directorships in such circumstances even though there is no realistic possibility that the common Directorship will raise competitive concerns clearly needs to be reassessed.

As I stated in my September 23, 1981 letter to then-Commissioner Clanton, a corporation must have access to the best possible outside Directors that it can attract. My experience is that outside Directors typically constitute a significant percentage of the number of Directors of many of today's corporations. Outside Directors are important advisors to management and trustees of the shareholders' interests. Outside Directors are especially valued since they are able to assist and guide the corporation from an independent vantage point not shared by inside Directors. In an era when liability exposures and other fiduciary concerns are making it increasingly difficult for corporations to attract qualified Directors with diverse backgrounds and broad experience, Congress should not continue to impose additional, unnecessary restrictions that further hamper this task.

I believe that the regulatory burdens are especially severe for corporations such as holding companies or companies with a number of subsidiaries or divisions that are engaged in a large variety of different businesses throughout the country. A mechanical application of Section 8 that embraces the ultimate reach of theories of "competition" makes it almost impossible for such companies to attract and retain able Directors with experience and judgment. In the long run, effective competition -- which is, in the last analysis, the purpose of Section 8 -- could be substantially adversely affected by any such doctrinaire approach which would deprive such companies of

Directors who could otherwise help make them more vigorous competitors.

The realities of the Boards of many of today's larger corporations should also be recognized. Based on my service as a Director and my other counseling activities over the years, I believe that it is fairly clear that Board members in many large enterprises today do not become involved in day-to-day competitive activities (e.g., pricing, marketing, customer and similar matters). Rather, the Directors are concerned with much broader issues of corporate endeavor -- overall direction, shareholder relations, capital structure, compensation programs and similar issues. Thus, the types of discussions at the Board level that Section 8 is designed to prevent are not likely to occur in the first place. These discussions are even less likely to occur if the affected products or services constitute a relatively small percentage of the corporation's total sales. A de minimis exemption thus will ease the regulatory burdens in those circumstances where competitive concerns are highly unlikely to occur in the first place.

This point should be stressed. I do not believe that legislative recognition of an appropriately-drafted de minimis exemption will in any sense weaken the antitrust laws that are at the heart of this country's competition policy. Horizontal collusion, which as I pointed out is the focus of Section 8, is prohibited by Section 1 of the Sherman Act and is subject to substantial criminal and civil penalties. S. 2163 does not in any manner restrict either the scope of, or the penalties for violating, Section 1.

Further, I do not believe that legislative recognition of a de minimis exemption will increase the probability that indiscretions will occur. To my knowledge, during the over 70 years of antitrust enforcement during which Section 8 has been on the books, there have not been any significant reported situations in which a Director of one corporation who happens to be a Director of a competitor has engaged in improper conduct. Even if it were to occur in the future, there would be ample

legal means for dealing with the indiscretion -- including jail sentences. In fact, I have not found any Section 8 case brought either by the government or by a private party where it appeared that any Director had engaged in any unlawful conduct -- except, of course, to have had the misfortune of having been ensnared by the technical reach of Section 8.

As outside counsel to many corporations, both large and small, and their Directors, it is my perception that Directors today rely upon experienced legal counsel in carrying out their duties as Directors. In some situations the principal legal advisor upon which such reliance is placed is house counsel; in other cases the principal legal advisor to the Director is a trusted outside counsel. In either case, the likelihood that the Director will act in a manner inconsistent with the objectives of Section 8 is even further reduced.

Let me turn now to the specific legislation that has been introduced, which appears to reflect the input and thought of a number of the various proposals regarding the de minimis issue that have surfaced and been debated over the last several years. S. 2163 as it is drafted would permit a de minimis exemption if the competitive overlap between the two corporations that shared a common Director involved less than a certain percentage of each corporation's total sales (i.e., 5% of each competitive product or service or 25% of all such products or services on an aggregate basis) or less than a certain dollar amount of each corporation's total sales (i.e., $1 million of all competitive products or services on an aggregate basis). S. 2163 would also permit an exemption if the competitive overlap involved less than 3% of the relevant market. I have no serious concern about an approach to the de minimis exemption based in part on a percentage (such as 3%) of the relevant market. I also endorse in principle a de minimis test that is based in part on an approach involving a small percentage or dollar amount of each corporation's total sales. Nonetheless, I would like to comment briefly about the specific

dollar amount of sales approach that has been proposed in S. 2163.

I preface this portion of my remarks with the comment that I believe that most practitioners will counsel their clients on the basis of a de minimis exemption that is based either on a percentage or dollar amount of their client's total sales. These two alternative standards are based on objective, easily determinable facts within the knowledge of the corporation -- i.e., sales of the competitive product and overall sales of the corporation. The third standard in S. 2163, which is based on a market share analysis, involves a degree of subjectivity since it depends on a judgment regarding the scope of the relevant market. Thus, I suspect that most practitioners and their clients will opt for the greater degree of certainty that the first two standards provide. For this reason, I believe that it is important to ensure that these first two standards are useful and workable in practice.

As currently drafted, competition under the $1 million standard would be de minimis only if the sales of all competing products or services of each corporation, on an aggregate basis for that corporation, are less than $1 million. I fear that this approach may be inadequate for two reasons.

First, this standard would apply only if each corporation's sales of all products or services where the two corporations compete are less than $1 million. Based on my experience in Section 8 matters, I believe that this requirement will probably make it very difficult for corporations that have a wide range of products to obtain an exemption under this standard. Nor does it appear that this aggregation requirement is necessary for competitive concerns. That is, I do not believe that there is a measurable increase in the risk of collusive behavior if two corporations compete to a minor extent in one product, as opposed to two or three different products.

Second, I believe that the $1 million threshold is too low in today's environment. For example, the Federal Trade

Commission in the past has accepted consent decrees in Section 8 matters that have permitted de minimis competition in the range of $5-10 million on a product-by-product basis. I do not believe that the Federal Trade Commission has encountered any difficulties with these consent decrees in practice. Thus, I believe that it would be more appropriate to permit a de minimis exemption when the competitive overlap is no more than, for example, $10 million in sales of any particular product or service of each of the two corporations.

I appreciate that it might be argued that $10 million might be too high in the case of smaller corporations where $10 million might be a significant portion of each of those corporations' total sales. To meet that concern, it appears to me that the bill could be amended to provide a de minimis exemption if the competitive overlap was the lesser of the 5% of total sales test contained in S. 2163 or the test that I am suggesting, i.e., $10 million of total sales of a particular product or service. The 3% market share test in the bill would then be retained as a third alternate test. I am attaching to my testimony the proposed changes to S.2163 that I am suggesting.

I would like to make one final comment. I have suggested today a minor amendment to S. 2163. Undoubtedly, some of my colleagues here today might support the principle of a de minimis exemption and yet nonetheless want to suggest their own changes to S. 2163. Such debate, I believe, is useful, and in my view has helped to focus the issue since I first wrote to then Commissioner Clanton in September 1981 urging adoption of de minimis guidelines as a matter of enforcement policy. I would hope, however, that concerns over the specific scope of the de minimis exemption can be resolved and, ultimately, that corrective legislation will be enacted in the near future. In the final analysis, I strongly believe that it is important to have realistic, workable de minimis rules that recognize business realities and permit individuals to determine their

obligations under the statute with an acceptable degree of certainty.

Mr. Chairman and members of the Committee, thank you for permitting me the opportunity to appear before you today. I would be happy to answer any questions at this point.

JONES, DAY, REAVIS & POGUE

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September 23, 1981

The Honorable David A. Clanton
Acting Chairman
Federal Trade Commission
Pennsylvania Avenue &
Sixth Street, N.W.
Washington, D.C. 20580

Re: Proposed Guidelines for Enforcement of Section 8 of the Clayton Act

Dear Mr. Clanton:

This letter proposes that the Federal Trade Commission ("Commission") issue guidelines clarifying the Commission's intentions with respect to the enforcement of Section 8 of the Clayton Act, 15 U.S.C. § 19.

I have been recently urged by several clients (for whom I have handled a number of Section 8 matters over the years, both in counseling and litigation) to offer for your consideration specific language for Section 8 enforcement guidelines. More generally, I think it is fair to say that the business community at large is virtually united in believing that the public interest would be served, the benefits of self-policing maximized and the costs of regulation reduced if the Commission would develop clear, workable guidelines that would recognize business realities and permit individuals and corporations to determine with an acceptable degree of certainty their obligations under the statute. The Commission, which has traditionally been the principal enforcement agency in Section 8 matters, has a unique opportunity to exercise its leadership in this area in a manner that is consistent with the policies of the Clayton Act, while at the same time eliminating uncertainty and undue technicalities that might otherwise discourage or even prevent the recruitment of able Directors for American corporations.

Many members of the business community are particularly concerned about Section 8 at this point because of one aspect of the recent opinion of the Ninth Circuit in TRW Inc. v. Federal Trade Commission, 647 F.2d 942 (9th Cir. 1981), in which the court stated that Section 8 does not contemplate a de minimis exception. This holding by the Ninth Circuit creates a split among the Circuits, since it conflicts with earlier decisions by the Southern District of New York (Paramount Pictures Corp. v. Baldwin-Montrose Chemical Co., Inc., 1966 Trade Cas. ¶ 71,678 (S.D.N.Y. 1966); United States v. Sears, Roebuck & Co., 111 F. Supp. 614 (S.D.N.Y. 1953)). Moreover, the Ninth Circuit's holding is inconsistent with the position taken by the Commission itself in numerous consent orders that recognize the de minimis principle under Section 8. The Ninth Circuit's interpretation substantially complicates the task of any corporation with any diversity in product offerings, or any individual considering election to or continuation on the Board of Directors of such a corporation, seeking to comply with the statute.

I. Policies Supporting the Issuance of Guidelines

By way of background, Section 8 of the Clayton Act prohibits certain common directorships involving banks and other corporations. As to industrial corporations, Section 8 prohibits a common Director between two corporations if: (1) one of the corporations has capital, surplus, and undivided profits of more than $1 million; (2) both corporations are engaged in interstate commerce; and (3) the two corporations are "competitors." Section 8 has not been amended since it was passed as part of the original Clayton Act in 1914. Thus, while the $1 million jurisdictional amount was undoubtedly intended by the framers of the statute almost 70 years ago to limit its application to corporations of significance, the $1 million amount today embraces nearly all corporations.

The business community desires clear and practical guidelines that would permit corporations and their Directors and officers to determine in a given case the Section 8 ramifications of their proposed actions. Ironically, strict and technical application of Section 8 severely limits the ability of corporations to attract and retain good outside Directors, and tends to make Section 8 counseling unduly conservative. First, the presence of a competitive product overlap of a de minimis amount apparently could disqualify a common Director between two corporations, at least in the Ninth Circuit, although it should not as a matter of logic. Second, the willingness of individuals to become outside Directors is chilled if they perceive that any degree of competition, no matter how trivial, may trigger Section 8 liability. A technical application of the statute thus directly conflicts with the public policy favoring the presence of outside Directors as important contributors to corporate governance and responsibility.

The importance to a corporation of recruiting the best possible outside Directors cannot be overstated. Outside Directors are important advisors to management and trustees of the shareholders' interests. Moreover, outside Directors are highly valued for their ability to assist and broadly guide the corporation from an independent vantage point not shared by inside Directors. At a time when public policy emphasizes the maximization of investment to enhance capital reserves for use by corporations to improve productivity and create jobs in the face of increasing foreign competition, unnecessary restrictions on the maximization of human resources upon which corporations also rely cannot be justified. Removal of any unnecessary regulatory burden imposed by Section 8 is, in this sense, consistent with current economic policies.

Guidelines would also serve the public interest because effective enforcement of Section 8 is especially dependent on the ability of corporations to monitor and self-police, through established compliance programs, the various other directorships that their Directors may accept. This self-policing, to be effective, requires a clear and realistic standard. Corporations, as well as their officers and Directors, that take antitrust compliance seriously should not be ensnared by technical and minor breaches of one of the basic antitrust statutes. In this regard, the Department of Justice's Merger Guidelines (which are currently under review) offer a useful analogy. Originally promulgated in 1968, the Merger Guidelines have had the salutary effect of permitting corporations to determine in advance the probable position that the government would take with respect to a merger and thus to assess the antitrust risks of a proposed transaction. As a long-time private practitioner, I can personally attest to many transactions that were either dropped or consummated essentially in reliance on the Merger Guidelines. Section 8 guidelines would have similar salutary self-policing effects, and thus serve the public interest.

At the same time, properly phrased enforcement guidelines would not conflict with the salutary purposes of Section 8. Rather, the relatively minor number of instances in which a de minimis or other exception would remove from consideration the products of a corporation -- and thus ease the regulatory and other costs placed on that corporation -- is amply justified by the unlikelihood that competition involving a product of such minor significance to the corporation would be affected through a common directorship.

In its enforcement of Section 8 the Commission has, over the years, recognized the wisdom of exercising discretion by limiting, in the main, its enforcement attacks under Section 8 to those common directorships that involved corporations that competed to a substantial degree. We suspect, but cannot document, that on occasions this policy has caused the Commission to refrain from prosecuting certain corporations or to resolve the matter short of issuing a formal complaint. Moreover, the Commission has in fact recognized a de minimis exception on numerous occasions in its consent orders, although admittedly never expressly conceding its existence. Section 8 consent orders have uniformly established reporting requirements and forbidden future common directorships only when competition between the two corporations exceeded a certain level. See, e.g., In the Matter of Midland-Ross Corp., Dkt. No. C-3035 (August 21, 1980); International Business Machines Corp., 3 Trade Reg. Rep. (CCH) ¶ 21,227 (1977); In the Matter of General Electric Co., 83 F.T.C. 1075 (1973). As previously noted, the Commission has in this respect acted in a manner consistent with the case law (other than the Ninth Circuit's unfortunate language in TRW). (Indeed, it is important to note that the Commission itself did not rule on the de minimis issue in TRW). Section 8 enforcement guidelines would, therefore, simply confirm and clarify this past prosecutorial approach.

## II. Proposed Guidelines

The guidelines proposed herein are consistent with the policies upon which Section 8 is based but are also responsive to the business concerns described above because they address areas of vagueness and rigidity under current judicial interpretations of the statute. First, the guidelines address the de minimis issue by proposing that the Commission adopt a modified version of the Midland-Ross consent order; an exception to the general de minimis guideline meets the special problem posed by large market shares in a small, concentrated market. Next, the guidelines establish standards permitting corporations to determine the extent to which the activities of a subsidiary should be attributed to its parent for Section 8 purposes. A brief discussion accompanies each guideline below.

### A. De Minimis Principle

At the outset, it is my view that the Commission should adopt, as a basic guide, the "principal products" approach that it has previously used in In the Matter of General Electric Co., 83 F.T.C. 1075 (1973). This approach excludes from Section 8 review products or services that do not ordinarily create a potential for competitive abuse because the revenues attributable to such products or services are small compared to the corporation's total revenues. If, however, the Commission believes that a more specific guideline should instead be promulgated, I suggest a de minimis principle, as follows:

1. Generally. The enforcement policy of the Commission is ordinarily to challenge under Section 8 of the Clayton Act those common directorships involving substantial commerce. The Commission believes in this regard that certain common directorships, by

reason of the size of the product lines and the small amount of commerce involved, are not likely to raise the problems that Section 8 was enacted to prevent. Thus, the Commission will not ordinarily challenge a common directorship between two corporations unless annual revenues of each corporation in any product or service in which the two corporations compete exceed ten million dollars.

For purposes of this and the subsequent guidelines, "annual revenues" of a corporation in a particular product or service shall be as stated on the last regularly prepared annual statement of income and expense of the corporation or, if not so stated, shall be as certified by an officer of the corporation (at the request of the Commission) based upon sales in the year to which such annual statement relates.

The Commission further believes that, as a result of inflationary expectations, the dollar amount in paragraph 1 may not in the future realistically reflect the level of commerce above which the Commission will be concerned. Thus, the Commission intends to review periodically, and to adjust as appropriate, the ten million dollar limitation.

This de minimis guideline generally follows the dollar standard that the Commission applied in the consent order in In the Matter of Midland-Ross Corporation, Dkt. No. C-3035 (August 21, 1980). It departs from Midland-Ross, however, in two respects. First, the Midland-Ross approach of examining the revenues of only one of the corporations seems unduly restrictive, since it could needlessly rule out a strong Director even if one of the corporations had a very low volume of sales. Second, the aggregation portion of Midland-Ross has been omitted since it is rather cumbersome and, in any event, is unnecessary once one has accepted the philosophy of the de minimis principle. My experience in practice suggests that a modified Midland-Ross approach of this type would permit a corporation to isolate with a degree of assurance those products or services upon which it must focus in complying with Section 8.

I recognize that this standard may not be regarded as sufficient if the two corporations substantially compete in a small, highly concentrated market in which their combined share is significantly high. For example, two competing corporations which each have annual sales in a particular product of $8 million might well be substantial competitors in a market with total industry sales of $18 million. Under the guideline proposed above, the competition would be de minimis since neither corporation has over $10 million of sales. To address this issue, and in the interest of developing an objective and clear statement of prosecutorial intention, I suggest an exception to that guideline. Because of potential definitional uncertainties in this exception, I have included a special notice and withdrawal provision applicable to situations in which the de minimis principle is met, but in which the Commission otherwise decides to proceed:

2. Exception for Highly Concentrated Markets. Notwithstanding the above-described statement of enforcement intention, the Commission believes that competition between two products or services, while small in an absolute sense, nevertheless could be significant because of the structure of the market within which the competition exists. More particularly, the Commission is concerned about competition occurring between two corporations in a small, highly concentrated market in which their combined share of the market is significantly high. Thus, it is the intention of the Commission to except from the application of the

de minimis guideline above, and to reserve the prosecutorial discretion to attack, a common directorship between two corporations when:

(a) any product or service market in which the two corporations compete is "highly concentrated" (i.e., 4-firm market share of approximately 75% or more [or other Commission-defined standard]), and

(b) both of the corporations are among the four largest firms in that market.

3. Notice and Withdrawal. In the event that the Commission decides to challenge a common directorship involving two corporations that meet the de minimis requirements of Guideline 1, it shall not seek a cease and desist order until the two corporations have been permitted a reasonable period to dissolve the common directorship, which shall not exceed the longer of (i) 180 days, or (ii) the earliest date (which shall not exceed one year from the date of the Commission's determination) that either corporation in its regular course of business would meet to elect directors and at which meeting the common director could be replaced.

B. Parent-Subsidiary Relationships

Section 8 guidelines should also address the issue raised by a common directorship that occurs because one corporation competes with the subsidiary of the second corporation, or in which two subsidiaries of the two corporations compete. As to this issue, the Second Circuit has suggested (without expressly deciding) that it is inappropriate as a general rule to attribute the activities of a subsidiary to its parent for Section 8 purposes. Kennecott Copper Corp. v. Curtiss-Wright Corp., 584 F.2d 1195 (2d Cir. 1978); see also United States v. Cleveland Trust Co., 392 F. Supp. 699 (N.D. Ohio 1974). This approach recognizes that the statute does not technically encompass such indirect situations within its terms, as expressly confirmed by the holding in Paramount Pictures Corp. v. Baldwin-Montrose Chemical Co., Inc., 1966 Trade Cas. ¶ 71,678 (S.D.N.Y. 1966).

Recent decisions which have discussed the parent-subsidiary issue under Section 8 have focused upon whether the parent "closely controls and dictates the policies of its subsidiary." See Kennecott Copper Corp. v. Curtiss-Wright Corp., supra at 1205; see also United States v. Cleveland Trust Co., supra at 712 ("where the major policies of the subsidiaries are dictated by the parents"). In none of these cases, however, has the simple fact of ownership or potential for control itself been regarded as enough to suggest attribution. The following guideline therefore adopts the "closely controls and dictates" standard articulated by the courts:

4. Attribution of Subsidiary Activity to a Parent Corporation. The Commission believes that under certain limited circumstances the products or services of one corporation should be attributed to a parent corporation for purposes of Section 8 analysis. It is the intention of the Commission in this regard ordinarily not to attribute the products or services of a subsidiary corporation to the parent corporation if:

(a) the parent corporation holds less than 50% of the voting securities of the subsidiary corporation and does not otherwise have the contractual power presently to designate a majority

of the directors of the subsidiary corporation; or

(b) as to a subsidiary corporation not encompassed within (a), the parent does not closely control and dictate the policies of the subsidiary corporation.

III. Conclusion

These proposed Section 8 guidelines remove unnecessary strictures that currently inhibit the ability of corporations to select strong, effective outside Directors. It is not my intention that these guidelines will weaken the enforcement of Section 8; rather I believe that they will enhance the efficacy of self-policing and reduce the enforcement costs of the Commission, while reducing other burdens currently placed upon corporations by the statute when those burdens produce no corresponding benefits. If either you or any other Commissioner or the Staff would like to discuss in further detail any aspect of the guidelines that I have proposed, please do not hesitate to contact me. In any event, I urge the Commission to adopt these guidelines promptly and, in so doing, to exercise leadership in this area of critical importance to the business community and the public interest.

Very truly yours,

Richard W. Pogue

cc: The Honorable Patricia P. Bailey
The Honorable Paul Rand Dixon
The Honorable Michael Pertschuk

R. W. Pogue proposal

II

99TH CONGRESS
2D SESSION

# S. 2163

To make necessary and appropriate amendments to the antitrust laws governing service as a director of competing corporations.

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IN THE SENATE OF THE UNITED STATES

MARCH 7 (legislative day, FEBRUARY 24), 1986

Mr. THURMOND (for himself, Mr. LAXALT, Mr. HATCH, Mr. EAST, Mr. MCCONNELL, and Mr. MURKOWSKI) (by request) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

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# A BILL

To make necessary and appropriate amendments to the antitrust laws governing service as a director of competing corporations.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That this Act may be cited as the "Interlocking Directorate Act of 1986".

SEC. 2. The fourth paragraph of section 8 of the Clayton Act (15 U.S.C. 19) is amended by—

(a) striking out "any one" and inserting in lieu thereof "each";

(b) striking out "$1,000,000" and inserting in lieu thereof "$10,000,000";

(c) striking out the period after "laws" and inserting in lieu thereof the following: ": *Provided*, That service as a director in two or more corporations shall not be prohibited by this section if the sales, determined on the basis of annual average gross revenues over the preceding two completed calendar or fiscal years, as may be appropriate in the circumstances, of each such corporation of each product or service sold by such corporations in competition with one another are either: (1) the lesser of (a) ~~(1) are less than~~ 5 percent of such corporation's total sales, unless the sales of all such products or services by such corporation exceed 25 percent of such corporation's total sales, or (b) $10,000,000, ~~(2) together with such corporation's sales of all other such products or services are less than $1,000,000,~~ or ~~(2)~~ (3) ~~are~~ less than 3 percent of the total sales in each line of commerce in each section of the country in which such corporations compete."; and

(d) adding at the end the following: "For each fiscal year commencing after September 30, 1986, the $10,000,000 and $1,000,000 thresholds in this paragraph shall be increased as of October 1 each year by an amount equal to the percentage increase in the gross national product, as published by the Department

of Commerce or its successor, for the year then ended over the level so established for the year ending September 30, 1985.".

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Senator METZENBAUM. I am somewhat concerned, Mr. Chairman, and I am not finding any fault, but I am somewhat concerned that all of our witnesses today are on one side of this issue. I cannot believe that there are not some other witnesses out there from other groups who would be concerned about this subject. I am not suggesting at this moment additional hearings, but I think we ought to at least learn from them what some of their concerns are, if at all.

The CHAIRMAN. Senator, we informed your staff, and they looked for some, but did not find any.

Senator METZENBAUM. That is entirely possible. I am not saying that there are.

The CHAIRMAN. If you have any witnesses——

Senator METZENBAUM. I appreciate that, and the chairman and I never have any difficulty in seeing that all witnesses are given an opportunity.

The CHAIRMAN. That is right.

Senator METZENBAUM. As I said earlier, my staff person is in the hospital——

The CHAIRMAN. We wanted some on the other side, but your staff did not find any, and we did not find any.

Senator METZENBAUM. I did not get a chance to discuss it with him.

The CHAIRMAN. Now, if I can take the other two witnesses and take 5 minutes each, and then I want to ask a couple of questions, and then I am going to turn the hearing over to Senator Metzenbaum, because I have go to go over and open the Senate.

Mr. Coyle, we will be glad to hear from you now.

## STATEMENT OF MARTIN A. COYLE

Mr. COYLE. Thank you, Senator.

First of all, Mr. Chairman, I have submitted a written statement which I would ask be put in the record.

The CHAIRMAN. Your entire statement will go in the record. Without objection, that will be done.

Mr. COYLE. Thank you.

[The prepared statement follows:]

TESTIMONY OF

MARTIN A. COYLE

VICE PRESIDENT, GENERAL COUNSEL & SECRETARY

TRW INC.

NATIONAL CHAIRMAN

Chairman Thurmond and members of the Committee, my name is Martin A. Coyle. I am appearing on behalf of TRW Inc. in my capacity as Vice President, General Counsel and Secretary of the corporation. TRW is a provider of high technology products and services primarily for the electronics and space systems and car and truck markets, with annual sales in excess of $6 billion.

I am also appearing on behalf of the American Society of Corporate Secretaries, in my capacity as National Chairman of that organization. The Society is a not-for-profit professional association whose membership is composed principally of corporate secretaries, assistant secretaries and other persons involved in duties normally associated with the corporate secretarial function. The Society has 2,800 members who represent over 2,100 publicly owned (and a few privately owned) corporations in the United States and Canada.

My position at TRW directly involves me in TRW's efforts to locate directors and in TRW's Clayton Act section 8 compliance program. Through my involvement in the American Society of Corporate

Secretaries I am frequently in contact with officials of other corporations who are involved in similar activities on behalf of their companies.

Thank you for providing me with the opportunity to appear today before this distinguished committee to express my strong support for S.2163, the Interlocking Directorate Act of 1986. I also want to thank you personally, Mr. Chairman, for scheduling a hearing on this important legislation so soon after you introduced it.

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U.S. corporations today more than ever have a critical need to retain the most highly qualified Board of Directors as possible. The issues which must be dealt with by corporate management are more complex than ever and the threat of foreign competition is high in virtually every industry, and on the increase. Public policy favors the presence of high caliber outside directors as important contributors to corporate governance and responsibility. It is also in a corporation's own self interest to have a diverse group of highly capable individuals serving on the corporation's Board.

However, the pool of individuals with the ability, time and inclination to serve as an outside director of a major corporation is very limited, and for several reasons America's major corporations are finding it increasingly difficult to recruit such individuals to serve on their boards. A recent survey of more than 500 corporate executives by a large executive search firm showed that 20 percent of those invited to serve on boards declined the invitations, the highest rejection rate in recent years. The reasons are varied, including the fear of negative publicity, excessive time demands, the proliferation of hostile corporate takeover attempts, shareholder suits, the difficulty in obtaining liability insurance for directors and officers, and potential financial loss.

The unduly harsh standards of Clayton Act §8 represent yet another significant hindrance to corporate efforts to locate qualified outside directors. The statutory language of Section 8, read literally, prohibits all director interlocks between competing corporations regardless of the amount of competition or competitive effect. This is in contrast to the other antitrust laws, which only prohibit specified conduct where that conduct is likely to have an anticompetitive effect. For example, Sherman Act §1 only prohibits unreasonable restraints of trade, and Clayton Act §7 only prohibits acquisitions where the effect "may be substantially to lessen competition or to tend to create a monopoly." Thus, in many cases two competing corporations which are prohibited from sharing directors nevertheless can enter into an arrangement which partially

restricts competition or can merge without violating the antitrust laws.

For many years, antitrust counsellors advised their corporate clients that there was a de minimis exception to section 8. However, recent decisions by the U.S. Court of Appeals for the Ninth Circuit and the Federal Trade Commission make it risky to rely on this advice.

In a case involving my company, the Ninth Circuit held that there is no de minimis exception to Section 8. TRW Inc. v. Federal Trade Commission, 647 F.2d 942 (9th Cir. 1981). Although TRW contended that there was no competitive overlap, the Federal Trade Commission found an overlap involving $7 million of revenue on the part of TRW (less than three-tenths of one percent of TRW's total revenues at that time) and $1 million of revenues on the part of the other company (representing less than one-tenth of one percent of that company's total revenues). The Ninth Circuit upheld the Commission's finding of a competitive overlap, but held that it was inappropriate for the Commission to have entered an order against TRW because there was no cognizable danger of a recurring violation.

More recently the Federal Trade Commission, in a 3-2 decision, held that there is no de minimis exception to Section 8. Borg-Warner, 101 F.T.C. 863 (1983), order vacated on other grounds, 746 F.2d 108 (2d Cir. 1984). The case involved an alleged competitive overlap of $5.4 million on the part of Bosch (approximately 3.1% of Bosch's total U.S. revenues and a much smaller fraction of Bosch's worldwide revenues) and $900,000 on the part of Borg-Warner (approximately three-one hundredths of one percent of Borg-Warner's total revenues).

The Second Circuit vacated the FTC order, likewise on the ground that there was no cognizable danger of a recurring violation. Thus the court explicitly declined to rule on whether there was a competitive overlap and on the availability of a de minimis exception to section 8.

The TRW and Borg-Warner decisions must be contrasted with earlier decisions which hold or suggest that there is a de minimis exception to Section 8,[1] and a number of FTC litigated and consent orders (including the Commission's proposed order in Borg-Warner) which incorporate de minimis exceptions.[2] These conflicts in the case law, and conflicts between the Federal Trade Commission's holdings in TRW and Borg-Warner and the Commission's litigated and consent orders, make it extremely difficult for corporate counsel to advise their clients on section 8 matters. If the statute is read in a literal, per se manner, Section 8 substantially hinders efforts of corporations to locate qualified directors while providing no countervailing benefit to our national competition policy.

Therefore, for many years, TRW, the American Society of Corporate Secretaries and other corporations and organizations have been urging the federal antitrust enforcement agencies to clarify the status of section 8 through the issuance of enforcement guidelines which incorporate a de minimis exception. It is our understanding that the Justice Department and the FTC believe that this is a matter which should be dealt with by Congress.

The present confusion as to whether section 8 incorporates a de minimis exception, and the undue harshness of the statute if it does not contain such an exception, call out for Congressional action at this time.

Reference to TRW's section 8 compliance program well illustrates the need for de minimis legislation. Even after we eliminate candidates for the TRW Board who already serve on the Board of an obvious competitor, approximately 50% of TRW's section 8 reviews uncover a

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[1] Paramount Pictures Corp. v. Baldwin-Montrose Chemical Co., 1966 Trade Cas. ¶71,678 (S.D.N.Y. 1966); United States v. Sears Roebuck & Co., 111 F. Supp. 614 (S.D.N.Y. 1953).

[2] E.g., Hughes Tool Co., Dkt. 9137 (1983); Midland-Ross, Dkt. C-3035(1980).

competitive overlap. In many, if not most, of these cases, election of the potential director clearly would have had no anticompetitive effect because of the small size of the overlap and/or the fact that the product in question was tangential to one or both companies' primary activities.

A few examples will illustrate the point:

- A common directorship between TRW and a company which manufactures automotive floor mats, among other products, was rejected because TRW's Automotive Aftermarket Group at the time distributed approximately $400,000 of automotive floor mats annually. This represented less than one-one hundredth of one percent of TRW's total revenues.

- A common directorship between TRW and a company which manufactures automotive touch-up paint, among other products, was considered. It had to be rejected because TRW at the time distributed approximately $300,000 of that product annually. This likewise represented less than one-one hundredth of one percent of TRW's total revenues.

- Another major corporation expressed an interest in nominating a TRW outside director to its board. Neither company had previously identified the other as a competitor. The law departments of TRW and the other corporation conducted thorough investigations pursuant to their normal compliance programs. It was concluded that the individual could not serve on the other company's board because of an overlap no greater than $13 million for TRW and $2 million for the other company, and possibly of significantly smaller magnitude. Both TRW and the other company have approximately $6 billion in revenues, so the overlap in question involved at most approximately two-tenths of one percent of TRW's total revenues, and approximately three-one hundredths of one percent of the other company's total revenues.

- A preliminary section 8 review indicated that a director of an airline might be precluded from serving on the TRW Board because that airline performed aircraft engine pump repairs which arguably were in competition with TRW's aircraft engine component repair business. TRW's annual revenues in the area of possible competition were estimated to be between $200,000 and $500,000, or less than one-one hundredth of one percent of TRW's total revenues.

- TRW was precluded from sharing a director with another major corporation which manufactures capacitors, even though the overlapping sales amounted to no more than one half of one percent of total revenues in the case of each corporation.

- TRW was precluded from sharing directors with another corporation manufacturing oil field equipment even though the overlapping sales amounted to no more than one half of one percent of total revenues in the case of each corporation.

These are only a few of the many de minimis overlaps that have been discovered through TRW's compliance program and that have resulted in rejection of the potential board nominees. In these cases it was highly unlikely that the TRW Board would even discuss the product in question, and the possibility of an anticompetitive effect was nil. Through my association with the American Society of Corporate Secretaries I have heard of numerous other section 8 "horror stories" involving other corporations. I am convinced that there are a large number of cases in which section 8 needlessly has deprived American corporations of the service of an individual who could have made a significant contribution as a Board member.

There are a number of ways in which section 8 could be amended to rectify the de minimis problem. S.2163's "percentage of sales" safe harbor is one such method. The other two safe harbors under S.2163, standing alone, are insufficient to solve the problem--the $1 million test sets too low a threshold and the market share test does not lend itself to certainty in counselling, which is vital in this

area of the law. Likewise, the proposal to increase section 8's jurisdictional threshold to $10 million, while clearly justified, alone will not solve the de minimis problem. Thus, I support S.2163, but I also could support alternatives which provide a reasonable safe harbor for de minimis interlocks.

I believe that there is virtually no risk that enactment of a section 8 de minimis safe harbor would lead to anticompetitive activity. TRW's section 8 compliance program would be pursued as vigorously after enactment of a de minimis rule as it is today. TRW's internal policies would continue to preclude the Company from electing to its Board any individual whose position as a director might cause even an appearance of anticompetitiveness. In the unlikely event that the TRW Board were to consider a matter involving a de minimis interlock, TRW would take steps to screen the director in question from participation in that matter. I am convinced that virtually all other major companies would act similarly.

Thus, a section 8 de minimis rule would eliminate a significant hindrance to corporations' effort to recruit the most highly qualified directors as possible, with virtually no risk to competition.

In summary, Mr. Chairman, allow me to emphasize the points I made at the beginning of my testimony. There is a critical need for American corporations to obtain high caliber directors, but for a variety of reasons it is becoming increasingly difficult to recruit such individuals. One of the significant hindrances is section 8 of the Clayton Act which has been held to prohibit the sharing of directors by competing corporations, regardless of possible competitive effect and even if the competitive overlap is only $1. Enactment of a section 8 de minimis safe harbor would significantly improve the ability of U.S. corporations to recruit directors, with virtually no risk to competition. Congressional amendment of section 8 to incorporate a de minimis rule is necessary. For this reason I am strongly in support of S.2163.

Mr. COYLE. I am Martin Coyle. I am appearing on behalf of TRW as its general counsel and secretary. I also serve as national chairman of the American Society of Corporate Secretaries, which has 2,800 members and represents 2,100 publicly held companies.

I can say that the lack of a section 8 de minimis is a significant concern to the membership of the American Society, and I am pleased to have the opportunity today to make a few comments.

I share the views of the other members of the panel that the pool of individuals available for boards of directors is becoming smaller and smaller. The problem is, as the Senator has commented, not just section 8; it is the directors' and officers' liability issue; it is additional risk, it is time commitment—it is a combination of many things. But section 8 does contribute significantly to that, and it is the thrust of what I want to make a few comments on.

I think I would best add value here if I commented on some of the problems we have had at TRW.

We have had numerous situations. We spend probably 15 percent of one antitrust lawyer's time and 15 percent of a paralegal's time doing nothing but section 8 reviews.

Senator METZENBAUM. I did not get that. You spend what?

Mr. COYLE. Probably 15 percent of one full-time antitrust lawyer and 15 percent of one antitrust paralegal doing nothing but section 8 reviews at TRW.

Senator METZENBAUM. Are you adding that many directors at all times?

Mr. COYLE. We are constantly considering directors, and unfortunately, we have to consider many more than we would otherwise like to because over 50 percent of them are excluded for section 8 reasons.

To give you examples of the types of things we run into, a common directorship between TRW and a company which manufactured automotive floormats had to be rejected when we found that one of our divisions sold $400,000 worth of floormats per year. We had to reject another individual because he was a director of a company that sold automotive touchup paint and it turned out that we had sold $300,000 of touchup paint. We had to exclude another person where there was an oil field equipment overlap, where annual sales were, I think, $13 million for TRW and $2 million for the other company.

We had a situation where we could not have an airline director also serve as a director of TRW because it turned out that that particular airiine performed aircraft engine pump repairs which possibly were in competition with our aircraft engine component repair business; even though TRW is obviously not an airline, we still could not have an overlap with that airline.

We had to exclude another individual because he served as a director of a company that manufactured capacitors, even though the sales amounted to no more than one-half of 1 percent of total revenues in the case of each corporation.

We have had numerous items like this that come as major surprises to the senior officers of TRW.

Senator METZENBAUM. Yours really all do deal with sales, actually, as I see it, and not with net worth?

Mr. COYLE. Yes. We find it somewhat difficult, with the number of reviews we have to do, to do a thorough market analysis in each situation and to determine not only the relevant market, but the participant's share in that market. It is just a phenomenal job. Our directors sit, in the aggregate, on 40 other boards. We have to constantly monitor every single new activity those 40 companies enter into, even though such activities would never rise to the point at which they might be considered at the board level.

So we not only monitor every new development of those 40 companies, which is a constant, continuing problem, but for every new candidate we have to look at all the boards of directors on which he already serves, every product line of those companies, and more often than not, we have to exclude the individual for something that nobody had any idea amounted to competition.

We know that we cannot share a director with General Motors which owns Hughes Aircraft. That is obvious. TRW is a competitor of General Motors. We are not concerned about that; we understand that. What we would like Congress to deal with is the problem that constantly comes up where small overlaps make it impossible to elect new directors.

Senator METZENBAUM. Mr. Coyle, I do not want to get into this.

The CHAIRMAN. Your 5 minutes are up now, and I believe we will now take Mr. Tausche.

Mr. Tausche is from Sears, Roebuck & Co., and you are appearing on behalf of the chamber of commerce.

## STATEMENT OF CHARLES TAUSCHE

Mr. TAUSCHE. That is correct, Senator. I am appearing here today on behalf of the U.S. Chamber, and we do support the legislation.

One of the advantages of being the last person on the panel is that everyone else has said what you are going to say, basically. But I do want to reemphasize what Mr. Coyle has said.

The CHAIRMAN. Do you have a written statement that you would like to go in the record?

Mr. TAUSCHE. Yes, I do, Senator, and I would like it to be included in the record.

The CHAIRMAN. Without objection, your written statement will go in the record. And you may take 5 minutes now.

Mr. TAUSCHE. Thank you.

[The prepared statement follows:]

STATEMENT
on
THE INTERLOCKING DIRECTORATE ACT (S. 2163)
before the
SENATE COMMITTEE ON THE JUDICIARY
for the
U.S. CHAMBER OF COMMERCE
by
Charles Tausche
on
April 28, 1986

My name is Charles Tausche. I am Antitrust Counsel for Sears, Roebuck & Company. I am appearing today on behalf of the U. S. Chamber of Commerce and its Council on Antitrust Policy of which I am a member, to offer the Chamber's support of "The Interlocking Directorate Act of 1986" (S. 2163), which will amend Section 8 of the Clayton Act.

The Clayton Act was passed in 1914 as part of a set of reforms designed to counter what was then perceived to be the actual or impending cartelization of America's basic industries, the so-called "Money Trust" whereby extensive interlocking directorates existed among large industrial corporations. Along with other measures designed to supplement the Sherman Act of 1890, Congress included Section 8, a provision prohibiting interlocking directors among banks and business corporations. Although the provisions of Section 8 dealing with banks were amended several times, the latest in 1935, the paragraph containing the prohibition of interlocks among business corporations has remained in the form originally enacted to the present date, a period of 72 years.

In enacting Section 8, Congress intended to ensure that an individual could not serve on the boards of more than one of the then largest American business corporations if such corporations were in direct competition with each other. This would prevent such an individual from making or influencing decisions involving the competitive behavior, including prices, of two or more corporations competing against each other in the same marketplace.

The passage of time, inflation, and changes in the nature and operation of American corporations have caused the unchanged and rigid prohibitions of Section 8 to become obsolete. As a result, the statute today produces results never intended by its framers, and has beneficial effect on antitrust enforcement or the American economy.

The amendments embodied in the "Interlocking Directorate Act of 1986" will not dilute the force of the original intent of Congress in enacting Section 8 nor the effectiveness of the statute. Rather, they are designed to eliminate prohibitions against "interlocks" among small corporations and prohibitions against interlocks involving a de minimis amount of commerce, neither of which have any harmful effect on competition. At the same time, the proposed amendments will allow diversified corporations an opportunity to draw directors from a larger pool of candidates.

To render Section 8 more realistic, Section 2(c) of the bill would establish de minimis exceptions to the general prohibitions of Section 8. First, it would exempt the situation in which the competitive sales of each of the competing corporations are insignificant to the total sales of each corporation. The purpose of Section 8 is to prevent an individual from making or influencing decisions concerning the competitive behavior of competing corporations. That objective is not at all compromised by the proposed amendments since it is highly unlikely that any matter concerning a tiny,

ancillary part of either business will ever require a decision of their board of directors or be brought to their attention.

The proposed amendments would exempt interlocks where sales of competing products or services, over a two-year period, constitute less than 5% of each corporation's total sales, and where the sales of all functionally similar products or services by each corporation do not exceed 25% of each corporation's total sales. The amendments also would eliminate situations in which the sales of competing corporations have no significance in the marketplace. Thus, when sales of each corporation are less than $1 million or represent less than 3% of the total sales in the market, Section 8 would not apply. Clearly, any agreement among such competitors, even to fix prices or restrict output, would have absolutely no adverse effect on the market, since those corporations would be competing with many other competitors comprising 97% of the market.

These sensible amendments are needed to restore credibility to Section 8.

Lest there be any mistaken impression that this statute, as presently constituted and interpreted, does not create problems for corporations attempting to assemble a board of capable outside directors, let me mention to you a few examples involving my employer, Sears, Roebuck & Company.

As I am certain all of you are aware, Sears, as a savings and loan holding company, cannot have any individual on its board who is also a member of the board of any financial institution. This greatly narrows the pool of available outside directors. There have been several instances in which Sears has foregone asking a highly capable and qualified individual, who otherwise does qualify, to serve on its board of directors because of the absolute coverage of Section 8.

Section 2(d) of the bill would change the jurisdictional requirements of Section 8, by requiring that the assets of both corporations, rather than those of just one, whose sales compete, exceed the monetary jurisdiction's limit, and by raising that jurisdiction limit to $10 million.

In 1914, a corporation having a $1 million dollars in capital, surplus, and undivided profits was an industrial giant. Congress intended Section 8 to apply only to such large corporations, the participants in the so-called "Money Trust." By 1985, almost any corporation has capital surplus and undivided profits of at least $1 million. Thus, a law intended to apply only to large corporations has come, in the course of time, to include almost all corporations, large and small. Requiring the Department of Justice to monitor the composition of the boards of directors of practically every corporation in America is undesirable and constitutes an administratively impractical task, as noted by the Stanley Congressional Committee in 1912.

The proposed jurisdictional limit of $10 million was not selected at random. A million-dollar corporation in 1914 would, on the basis of the index value of the dollar, be a corporation whose assets in 1985 would approximate $10 million dollars. Clearly this change, to bring Section 8 into line with present-day economic realities, is needed badly.

To prevent the jurisdictional threshold of the statute from again falling so badly out-of-date, subsection (d) of Section 2 of the bill provides a mechanism whereby the jurisdictional threshold will be raised each year by

an amount equal to the increase in the Gross National Product. Since it is unlikely that Congress will reconsider Section 8 of the Clayton Act often in the future, this is a sensible manner of insuring that the statute will not again become obsolete.

Although very few cases have been decided under Section 8, several courts that have considered the statute have construed its language strictly, allowing for no de minimis exception. For example, if the headquarters building of a large manufacturer of automobiles is adjacent to the headquarters building of a large department store chain, and if each of the companies operates a cafeteria in its buildings that is open to the public and competes for customers, an individual could not sit on the board of directors of these two companies without violating Section 8 of the Clayton Act. This result, while ludicrous. is ordained by the statute as currently interpreted by the courts.

A few years ago, the question arose whether an individual could serve on the boards of Sears and the Quaker Oats Company, then almost exclusively a marketer of food products. It was discovered that Sears had a small business of selling yarn, patterns, and other knitting supplies amounting to approximately $10 million in annual sales, and that Quaker owned a small catalog company that sold similar products, with sales of approximately $16 million. Sears' sales of these items represented less that 4/100 of 1% of its annual revenues and Quaker's sales less that 1.1% of its total revenues. Shortly thereafter, Quaker divested the catalog operation, and Sears terminated its yarn and knitting supply business. However, the existence of these small businesses at the time might well have prevented an individual from serving on the boards of both of these corporations, even though the total competing sales of each were insignificant compared to the sales of the respective corporations and to the entire market.

The question also once arose whether an individual could serve on the board of RJR Nabisco Inc., a tobacco company, and Sears. RJR Nabisco Inc. sells seeds, plants, garden implements, toys, and gift-food items through catalogs. Together, these items represent less that 9/10 of 1% of its total revenues. Sears' sales of these lines are far less than 1% of its total revenues. Despite the insignificance of these sales to each corporation, it was recommended that the individual should not serve on both boards because of the prohibitions of Section 8 of the Clayton Act.

In the mid-70's, the question arose as to whether an individual could serve on the board of directors of G. D. Searle, a pharmaceutical and medical supply company, and Sears. Searle sold approximately $8 million of

wheelchairs, bedding, and other hospital supplies, while the commercial sales division of Sears sold about $2 million of similar products. These sales amounted to 8/1000 of 1% of Sears' revenues and 1/10 of 1% of Searle's revenues. Subsequently, Searle divested itself of this subsidiary, and Sears withdrew from this business. However, at the time, it was believed that this situation might fall within the purview of Section 8.

I am sure that you will agree that Congress has never intended to prohibit an individual from serving on the board of more than two corporations where their competing sales constitute an insignificant percentage of each corporation's sales, or where such sales have no competitive significance in the market. Nor has Congress intended to prohibit interlocks among small corporations which do not have competitive significance.

These amendments embodied in the "Interlocking Directorate Act of 1986" will bring the Clayton Act into line with the realities of 1986. The U.S. Chamber strongly urges you to act favorably on S. 2163. Thank you.

Mr. TAUSCHE. I would like to emphasize and reemphasize a point that Mr. Coyle has made. Sears, Roebuck, as you know, is in many businesses, and we have exactly the same problem that TRW has, in addition to the fact that we are a financial institution, which eliminates everybody from financial institutions. Then we start looking at other companies. We have our quota of professors and consultants and such people, but basically, you also want on your board some management officials from other companies, and this is becoming exceedingly difficult. The examples he gave mirror the examples we have.

We had one example where one of the companies, R.J. Reynolds, which is a tobacco company, had a small operation where they sold seeds in catalog, and Sears sells seeds. I think the percentage represented 0.9 percent of Reynolds' sales—that is nine-tenths of 1 percent—and our sales of those products represented far less than 1 percent. And yet, that is an overlap.

There are other examples in my written statement, involving sales by G.D. Searle of 0.1, or one-tenth of 1 percent of their sales, and eight one-thousandths of 1 percent of our sales; but yet, a competitive overlap.

I once heard, I believe it was Mr. Ginsburg, give an example that if two corporations had headquarters adjacent to each other, on the same block in the city, and they both operated cafeterias that are open to the public, in theory and in fact, if they competed, that is covered by the statute. I say to you that that is not correct, and it is having an effect on large, diversified corporations in finding directors. I believe that a safe harbor is necessary to allow these corporations to have a wider pool of directors to choose from.

The original intent of the statute, as you know, was aimed at the Money Trusts and the cartelization of big corporations: $1 million in those days, in 1914; 72 years later it is achieving results never intended by Congress, and is impeding director selection. I believe that this legislation remedies those problems, and I support it.

The CHAIRMAN. Thank you very much.

I have two questions I would like to ask all of you. One of the safe harbors contained in the administration's proposal will allow director interlocks between companies that compete in a line of business if their sales in that line of business do not constitute more than 5 percent of their total sales.

This would seem to allow interlocks between very large corporations that might have substantial shares of a market so long as their sales in that market do not exceed 5 percent of the corporations' total sales.

Now, in your view, is this appropriate, or should the bill be refined to limit the market shares of firms that are permitted to have interlocking directorates?

Mr. Halverson, we will start with you.

Mr. HALVERSON. Well, I think that is probably captured within our 10-percent aggregate of the firms that share competing directors. But we did use a dollar amount rather than a 5-percent amount.

However, since our exemption is broader, I would support the 5-percent-of-sales exemption. It is a safe harbor; it is an easily identi-

fiable safe harbor. Five percent of total sales is identifiable by any corporation, and therefore, it can be policed easily.

And I think we are looking at something for advice purposes and for safety purposes, for asking a director to serve without fear of liability, that can be policed easily.

The CHAIRMAN. Mr. Pogue.

Mr. POGUE. I think the issue you raise, Senator, can be approached in part if you have, instead of strictly a 5-percent test, an alternate test, so that if you had a test in which the safe harbor was 5 percent or, let us say, $10 million or some dollar figure, whichever is less, then you would tend to keep out of the consideration markets in which there are huge volumes of commerce.

The CHAIRMAN. Mr. Coyle.

Mr. COYLE. I will give you my own view rather than the American Society's view on this. I think the 5 percent may be a little high. Five percent of a company like TRW is $300 million, and $300 million can be the subject of an area of the board. Now, once you assume that there is a proper need for section 8 in the first place, then I would suggest that maybe 5 percent is on the high side.

I frankly support a concept basically that is the lesser of $10 million or 5 percent, which I think deals with that type of problem. But I think the key point is that we need to address the de minimis issue. Five percent may be a little too high.

The CHAIRMAN. Mr. Tausche.

Mr. TAUSCHE. Senator, I think that probably the concept of a dollar amount has some validity. But I am very concerned about the fact that we are dealing with an evolving economy, and dollar limits put in statutes which are only revisited every 72 years become obsolete, as is proved in the jurisdictional section of this law.

So I would urge that if you use a percentage and a dollar limit, the section which automatically provides that the dollar limit rises with the GNP be also applied to any dollar limit in the de minimis safe harbor section, because otherwise, 20 years from now, maybe what is $10 million now will be peanuts, and we would be back in the same problem we have right now.

So I would urge that if a dollar limit is used rather than a percentage, that it is geared somehow or the other to rise automatically with the economy.

The CHAIRMAN. Thank you very much.

Now I will ask this question of all of you. Could you summarize what you regard as the main benefits of making the proposed changes in section 8 of the Clayton Act?

Mr. Halverson.

Mr. HALVERSON. Yes, Mr. Chairman. The benefits are, in my view, at least three. One, we update what is obviously an outdated statute. It was never intended when it was originally enacted to achieve the result of barring directors from serving in de minimis situations.

Two, we give clear, definable safe harbors, so that when giving advice, directors feel that they will not be subject to possible prosecution for what are de minimis situations.

And three, we aid corporations in getting qualified outside directors to help police the activities of the corporation.

The CHAIRMAN. Mr. Pogue.

Mr. POGUE. I would agree with what Mr. Halverson just said. I would add the point that today there is great confusion, I believe, on the part of potential directors, and they want assurance from counsel that if they go on a board, they will not be personally embarrassed or personally subjected to litigation, and therefore, I think that this legislation will go a long way to give potential directors a feeling that they can go on a board without any question being raised, and carry out their fiduciary duties to the shareholders.

The CHAIRMAN. Mr. Coyle.

Mr. COYLE. I think that you will have better directors with more experience if this legislation is enacted. I think in a sense, it makes companies more competitive by reducing unnecessary bureaucratic costs that companies have to go through in dealing with section 8, with very little gain. I do not believe it in any way undercuts the basic premise of the antitrust laws. Anticompetitive activity can be reached under Sherman 1 and other provisions.

The CHAIRMAN. Mr. Tausche.

Mr. TAUSCHE. I think we must always remember that section 1 of the Sherman Act is in effect and does prohibit any sort of horizontal agreements. With that in mind, I think that this is merely an addition, the prophylactic rule, and it should be applied reasonably to the modern corporate situation. I believe that this bill does that and allows a large corporation, particularly a diversified one, to have a larger pool from which to draw expert managers who are successful in managing their own companies and can lend their advice and counsel to another.

The CHAIRMAN. Now, in 1914, when this statute was passed, $1 million was the limit. How does $1 million in 1914 compare with the dollar market today, and what amount would it be equivalent to today?

Mr. TAUSCHE. My economist, Senator, tells me $10,700,000 today versus $1 million in 1914.

In other words, $1 million in 1914 would be $10,700,000 today.

The CHAIRMAN. I am wondering if that is the reason the administration chose $10 million.

Mr. Ginsburg, could you answer whether that is the reason you chose $10 million?

Mr. GINSBURG. Yes, Mr. Chairman, thank you.

We considered various indexes for updating the figure. If you look at the Consumer Price Index, the factor is approximately 11—using the Consumer Price Index, the multiplier comes out to approximately 11 or perhaps, as Mr. Tausche suggested, 10.7 times the original number.

We also looked at the possibility of using the gross national product as the index, because the significance of firms in the overall economy has diminished to some degree with the growth of that economy. That would suggest a multiplier of 80, and we would raise the threshold on that approach to $80 million.

We think that $10 million is a more reasonable figure, that the Consumer Price Index, if one has to choose, is probably the better index.

The CHAIRMAN. So you feel that $10 million today is equivalent to the $1 million back then, approximately?

Mr. GINSBURG. Yes, it is, Senator.

The CHAIRMAN. Now, do any of you have anything else you wish to add at this time? I am going to have to leave in about 3 minutes to go and open the Senate, and Senator Metzenbaum will continue with any questions he has.

Senator METZENBAUM. Mr. Chairman, Mr. Coyle wants to invite you to come out and visit their new headquarters in Cleveland, which are absolutely superb and about as fine corporate headquarters as any you could possibly see.

They will give you a totally conducted tour; they will make it available to you to address many of their executives. They would just be very honored to have you, and we would be grateful to you if you made that trip. And you can bring some of the other Senators with you.

Mr. COYLE. The Senator is absolutely right.

The CHAIRMAN. That is a very thoughtful, kind and generous invitation. Maybe sometime we can accept it.

Senator METZENBAUM. You would like it. It is a fantastic headquarters.

The CHAIRMAN. Thank you very much.

Mr. Ginsburg.

Mr. GINSBURG. Thank you, Mr. Chairman.

I would just add one observation that may be helpful to Senator Metzenbaum. He expressed concern about the use of the overlapping director as a vehicle for anticompetitive activity, and of course, that is what lies behind section 8 in the first place.

In looking at the very large number of smaller companies that have been indicted over the years for antitrust violations, companies that are not subject to the prohibition of section 8 because they fall below the $1 million threshold, we find that they do not use a common director to accomplish their purposes. They use something that is even simpler and less easily exposed, and it is called the telephone. As long as that is available to people to engage in price-fixing activity, it will be a preferred vehicle, rather than involving a board of directors where a large number of people can act as witnesses.

The CHAIRMAN. Thank you.

Is there anything else any of you would like to say now before I leave?

Mr. HALVERSON. Mr. Chairman, I just want to underscore the fact that since the American Bar Association position supports broader safe harbors than the administration position, the American Bar Association supports the administation proposal.

The CHAIRMAN. In other words, the American Bar Association would go further, but they do go along with this bill.

Mr. HALVERSON. We would support the administration proposal.

The CHAIRMAN. I see.

Senator METZENBAUM. I would like to ask a question.

The CHAIRMAN. And Mr. Pogue, what about that?

Mr. POGUE. Well, certainly, I would say the same thing. The important thing is to resolve this issue as promptly as possible. You can have differences on exactly how much fine tuning should be

engaged in, but I would hope that the standards for the safe harbor can be arrived at very quickly, so we can get this amendment on the books.

The CHAIRMAN. Mr. Coyle.

Mr. COYLE. I agree. I have nothing else to add.

The CHAIRMAN. In other words, as I understand it, most of you would favor a broader base, but you go along with this?

Mr. COYLE. No. In fact, I think I said in answer to a question that if anything if you start with the premise that you are trying to permit only those overlaps that are unlikely to become the subject of board consideration, then it is possible that the proposed de minimis standard is a little on the high side. There are variations that can work; I am not advocating a broader application for the de minimis rule.

Senator METZENBAUM. I think you had indicated, Mr. Coyle, that the 5 percent is perhaps high, and you and Mr. Pogue both indicated that perhaps some dollar amount should be used, and that whichever is the lower ought to be the criterion.

Mr. COYLE. I feel that most of the de minimis problems I have discussed would be dealt with if you had, for example, a lesser of $10 million or 5-percent rule. That would take care of the problem—when you are talking 5 percent of Exxon or General Motors, you are talking a nice piece of change.

Senator METZENBAUM. I bet.

The CHAIRMAN. Mr. Tausche.

Mr. TAUSCHE. I would just say that I understand that certain other provisions in Mr. Ginsburg's package are somewhat controversial, and I do not really think this one is. It can be fine tuned. I do hope that we will get some legislation, because 72 years is a long while to alleviate a problem.

The CHAIRMAN. Mr. Ginsburg.

Mr. GINSBURG. Mr. Chairman, in response to your questions and some of the comments that the other witnesses and Senator Metzenbaum have made, I think I can say with confidence that the administration is open to adding a maximum dollar limit on the safe harbor that is based on a percentage of the corporation's sales. Our purpose in this legislation, as reflected in today's testimony, is to alleviate a problem concerning truly de minimis competitive impact, not to create a problem that could have anticompetitive potential.

So we are quite open to that sort of refinement.

The CHAIRMAN. Mr. Ginsburg, I wonder if you would mind conferring with Senator Metzenbaum's staff, and if there are any differences there, see if you can get them ironed out.

Senator Metzenbaum.

Senator METZENBAUM. That would be fine. I have a couple of questions, Mr. Chairman

One of the questions that is sort of basic to this whole issue relates to the fact that it has become an accepted norm in the American——

The CHAIRMAN. Excuse me, Senator Metzenbaum. Would you wind up the hearing?

Senator METZENBAUM. Yes, Mr. Chairman.

It has become an accepted norm in the American corporate community that there is only a certain universe of people that we can consider for corporate directors, and we talk about the fact that putting certain people on provides their expertise.

Some of us have the feeling—and we had some hearings on this some years ago—that America's corporations are not necessarily looking at some of the people who might very well serve on their boards and might well contribute very much, but that what happens is that TRW looks at General Motors' board, and the General Motors board looks at the RCA board, and they look at the GE board—they will not have to look at each other's boards pretty soon—and they just look at that whole crowd of players: "Oh, yes, I know him. I played golf with him." Or, "I had lunch with him."

It is probably heresy to suggest it, but each of you have tremendous numbers of people who are shareholders in your corporations, and for the life of me, I have never heard of any corporation that looked down its list of corporate shareholders, with the exception of those where you see somebody who holds 12 percent of your stock. But then we are not talking about that, but somebody who holds half a percent of your stock, or a quarter of a percent of your stock, has enough invested in your company to indicate that they have some wealth, second, that they understand the value of money, and third, that somewhere along the line they learned how to earn money or else they had the right parents.

And what bothers me is that as you talk about this, all you talk about is the fact that you cannot find enough experts, corporate managers.

I think that there are people—I know you mentioned you have some academicians, and I forget what else—but I am sure that each of you picks one or two out, maybe a black or a woman or whatever the case may be. I just wonder whether that is not part of your problem, that you are not looking far enough afield.

Mr. POGUE. Senator, whether or not those comments were well taken a few years ago when the study you referred to was issued, I really do not know. But I think that today you will find that the process of nominating directors takes into account various considerations including some of those which you have just articulated.

What we are talking about here is that the pool that you are looking at should include not only smaller shareholders and other persons selected for their social responsibility and contributions, but also some directors who have experience in some extremely complicated matters that involve a lot of money, because in essence the director is there as a fiduciary to look after the interests of the shareholders, and you want people who have experience in these important matters.

So, what we are concerned with is not that the corporations are not bringing on the boards the other people who do not fall in that category, but what we are concerned about is that you are excluding the group to which you are referring.

Senator METZENBAUM. Let me ask the secretary for TRW—I have a lot of respect for the company; I am pleased that your headquarters are in Cleveland, and when you could have moved, you stayed. But having said that, how many board members do you have?

Mr. COYLE. Fifteen, sir.

Senator METZENBAUM. Of the 15, how many come from the ranks, how many of them are—well, first of all, how many are members of the company itself?

Mr. COYLE. Three.

Senator METZENBAUM. That is a very respectable percentage, and I commend you for it.

Mr. COYLE. It will be two, shortly.

Senator METZENBAUM. Of the other 12 presently, do they all come from the corporate world?

Mr. COYLE. No. If you will not hold me to the exact percentage without checking, a little bit over half are from the corporate business world. We have individuals like Marty Feldstein, the economist; we have a scientist; we have people from the international community.

So we try very hard to have a broad-based, experienced board. But we also try very hard to find the finest in their fields, to add the most value to the company.

And of course, when you go and you try to find the finest it turns out that you are not the only one interested in those particular individuals; other companies are interested in them also and that leads you to the problem of section 8.

From time to time we do have shareholders submit recommendations, and we do look at them. The nominating committee of TRW is made up of independent board members not associated with management, and they spend a good amount of time talking about those recommendations and trying to determine whether they have the criteria and experience.

Senator METZENBAUM. Do you recollect any one instance in which a member of the board became a member of the board who was some ordinary shareholder—I am not talking about somebody from a bank, but I am talking about ordinary shareholders. Do you understand what I mean?

Mr. COYLE. Yes.

Senator METZENBAUM. They made a recommendation and that person ended up on the board?

Mr. COYLE. I know of no such example of that.

Senator METZENBAUM. Mr. Pogue, do you have any recollection of anybody ever having been nominated to a corporate board from an average shareholder, or even a strong shareholder, who then made it onto the board? And I am not talking about somebody who is threatening to move up and get a 5-percent or an 8-percent position, whatever the case may be.

Do you have any recollection of that?

Mr. POGUE. I do not think that happens very often in that manner. Certainly, there have been suggestions to a number of corporations with which I am familiar that a representative of, let us say a minority community such as the black community, be admitted. And those recommendations are taken very seriously, and many corporations have such members on their boards.

Senator METZENBAUM. Mr. Ginsburg.

Mr. GINSBURG. Senator, I am not sure of the exact nature of your concern, but I would point out that most States do require directors to hold a certain minimum number of qualifying shares, so that if

they do not already have the perspective of the small shareholder when they come on board, they are likely to acquire it.

Senator METZENBAUM. Delaware does not, does it? Delaware has no such requirement. That is where most corporations are headquartered. I think you are overstating that case, Mr. Ginsburg. I do not think that that is a factor, as a general rule, that most directors hold some minimum number of shares.

Am I wrong about that? And one of you are welcome to respond, but that is not my recollection in my own involvement in the corporate world that that was any criterion at all.

Mr. COYLE. There may be some States that require qualifying shares; I know Ohio does not.

Senator METZENBAUM. Ohio does not. Delaware does not. Is that right?

Mr. POGUE. I cannot answer it; sorry.

Senator METZENBAUM. Mr. Halverson.

Mr. HALVERSON. I cannot answer it, either. I know there are several States where it is not required.

Senator METZENBAUM. I think you have overstated that case, Mr. Ginsburg. It may be the case in Illinois, I do not know. But I would say that I will bet the overwhelming majority of directors appointed to major corporations do not hold shares when they go on it.

Mr. GINSBURG. Senator, if Delaware and Ohio do not require it, then I should withdraw the point. But I wonder what the experience of our witnesses is with respect to company policy on shares or options, and whether that is encouraged.

Senator METZENBAUM. Shares or options?

Mr. GINSBURG. Yes.

Senator METZENBAUM. I do not think directors very often get options, do they?

Mr. POGUE. That is not very usual.

Mr. COYLE. It is not usual. At TRW we encourage all the directors to be shareholders, and that is a criterion we look at when nominations are brought before the board.

Senator METZENBAUM. But if you want somebody out there, and he or she is somebody who does not have any shares, you might very well say to them, "We think it would be good if you picked up a little block of shares or something, just so you can feel you are a shareholder." But that would not be a deterrent?

You are shaking your head in the negative, Mr. Coyle. The reporter cannot record that.

Mr. COYLE. I agree with that. I am sorry. That would not be a deterrent.

Mr. POGUE. I think the point, Senator, whatever the merit of what you are suggesting may be, is that people who fall in the category that you have identified are not excluded from consideration. We are dealing here with a group who by law, as interpreted in the courts now, are being excluded, and we are trying to remedy that exclusion.

Senator METZENBAUM. As I said to you on an earlier point, I think $1 million of 1914 dollars is a different figure today. I think the safe harbor provision, and I understand where you are coming from, but I am not sure just how far we should go in that respect. Certainly, it is already indicated by your own testimony that the

language goes further than it should. But I think we will have some discussion and see whether or not we can work out something that will take care of your concerns without totally letting down the bars and seeing to it that the original thrust of this legislation, this law, not be totally emasculated.

With that, this hearing stands adjourned.

Thank you, gentlemen.

[Whereupon, at 11:02 a.m., the committee was adjourned.]

# APPENDIX

ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK
COMMITTEE ON ANTITRUST AND TRADE REGULATION

REPORT OF SUBCOMMITTEE ON
SECTION 8 OF THE CLAYTON ACT

ANALYSIS OF THE PROPOSED INTER-
LOCKING DIRECTORATES ACT OF 1986

The Reagan Administration recently proposed an amendment to Section 8 of the Clayton Act, 15 U.S.C. § 19, which would relax the strict prohibition on interlocking directorates and exempt some corporations from the requirements of Section 8.

In its present form, Section 8 of the Clayton Act bars any person from serving as a director on the boards of two or more corporations which have capital, surplus and undivided profits in excess of $1,000,000 and which, by virtue of their business and location, compete with one another. Section 8 generally has been construed as establishing a "per se" rule. Thus regardless of purpose, effect or other circumstances, Section 8 strictly prohibits a director from sitting on the boards of two or more covered corporations that are or theretofore have been competitors.[1/]

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1/ Protectoseal Co. v. Baroncik, 484 F.2d 585, 589 (7th Cir. 1973); United States v. Sears, Roebuck & Co., 111 F. Supp. 614, 617 (S.D.N.Y. 1953); see also Bankamerica

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The proposed Interlocking Directorates Act of 1986 (the "Act") would amend Section 8 in three significant respects:

First, the Act would raise the jurisdictional threshold from $1,000,000 to $10,000,000. It also would change Section 8 to apply only where both corporations satisfy the threshold; the current statute applies if either corporation satisfies the threshold. Thus, relatively small corporations would be exempt entirely from the Section 8 prohibition.

Second, the Act would add an indexing provision to Section 8 which would adjust the jurisdictional threshold annually by an amount equal to the percentage change in the Gross National Product as compared with the year ended September 30, 1985.

Third, and most importantly, the Act would create a de minimis exemption to Section 8 by establishing three "safe harbors" within which interlocks would be permitted. Corporations, each of whose sales of any competing product are less than 5 percent of their respective total sales, or each of whose sales of any competing product are less than 3 percent

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Corp. v. United States, 462 U.S. 122, 127 (discussing the legislative history of Section 8).

of any relevant market in which they compete, or whose "competitive overlap" products amount to less that $1,000,000 of the business of each, would be exempt from the strictures of Section 8.

The Act would substantially modernize and clarify Section 8. We endorse it with one substantive and one technical exception. First, the proposed de minimis exemptions could exempt interlocks between relatively small companies which, despite their size, dominate a specific geographic area. Accordingly, we support the proposed legislation provided the safe harbor exemptions are tightened to eliminate this defect. Second, the indexation provision should be clarified to specify the particular Gross National Product measure to be used.

Jurisdictional Threshold

The proposed amendments raising the jurisdictional threshold from $1,000,000 to $10,000,000, applying the threshold to both rather than to either corporation, and indexing the threshold to keep pace with the growth of the economy are a welcome modernization of Section 8 and are in harmony with the original intent of Congress in enacting the Clayton Act.

The Clayton Act was enacted during a time when there was widespread concern over corporate bigness, monopo-

lies and the manipulation of prices and competition. See generally Travers, Interlocks in Corporate Management and the Antitrust Laws, 46 Tex. L. Rev. 819 (1968). Since its enactment in 1914, however, the jurisdictional threshold of Section 8 has remained unchanged. Corporations and the economy in general have grown to a size where corporations which have $1,000,000 in capital, surplus and undivided profits are relatively small and are unlikely to have the substantial economic impact feared in 1914. Therefore adjusting the jurisdictional threshold upward represents merely a recognition of the changes in the economy over the past 72 years.

Further, the indexing provision, which would automatically raise the jurisdictional threshold in amounts commensurate with the growth in the economy,[2/] will effec-

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2/ The use of the Gross National Product as the index for adjusting the threshold is an imperfect measure, as all sectors of the economy do not parallel Gross National Product movements. Any index of general applicability, however, would suffer from the same problem. On balance, we believe the benefits of Gross National Product indexation to outweigh its disadvantages.

We note also that the Administration bill does not specify which of the Gross National Product measures published by the Department of Commerce is to be used. We infer that the intention is to use Gross National Product as opposed to the Gross National Product in Constant Dollars, the latter of which is adjusted for

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tively keep Section 8 up-to-date. This will avoid the problem of continually amending the jurisdictional threshold.

Safe Harbor Provisions

The Act would create three safe harbors to Section 8's flat prohibition on interlocking directorates. First, corporations may share a common director if the total sales of "competitive overlap" products amounts to less than $1,000,000 of each corporation's business.3/ Second, corporations each of whose sales of any competing product are less than 5 percent of its total sales would be protected from the strictures of Section 8. Third, corporations each of whose sales of any competing product were less than 3 percent of any relevant market would be exempt from Section 8. In each case, the Act attempts to exempt corporations where competition between them is de minimis and thus where a shared director is no threat to competition generally.

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inflation. This would be appropriate in order to make the measure of the size of the economy comparable to company accounting figures, which are not inflation-adjusted. We recommend that the bill be amended to specify that the intended Gross National Product measure is in current as opposed to constant dollars.

3/ The Act provides that the $1,000,000 amount would also be indexed to reflect growth in the Gross National Product.

A de minimis exemption makes eminent sense as a matter of policy. A ban on interlocking directorates where the corporations are not in competition with one another to a significant degree, or where they compete in a business that is not significant in relation to their overall operations, serves no real function. Moreover, statutory change to implement a de minimis exemption would substantially clarify the scope of Section 8. In recent years, the question of whether Section 8 bars all interlocking directorates, even where the competing sales between the interlocked corporations are small, has divided the courts. Compare TRW, Inc. v. FTC, 647 F.2d 942, 948 (9th Cir. 1981) (stating in dicta that there is no de minimis defense) with Jicarilla Apache Tribe v. Supron Energy Corp., 728 F.2d 1555, 1561 (10th Cir. 1984) (affirming lower court's decision that a mere "technical violation" was not sufficient to make out a case for damages under Section 8); Paramount Pictures Corp. v. Baldwin-Montrose Chemical Co., Inc., 1966 Trade Cas. ¶ 71,678, at 86,065 (S.D.N.Y. 1966) (recognizing and applying a de minimis defense).

Further, the FTC's position on the existence of a de minimis exemption to Section 8 has been confusing. The FTC steadfastly has refused to recognize a de minimis defense in adjudicative matters. See In re Borg Warner Corp., 101 F.T.C. 863 (1983) rev'd on other grounds, 746 F.2d 108 (2d

Cir. 1984); TRW, Inc. v. FTC, supra 647 F.2d at 948; In re Kraftco Corp., 81 F.T.C. 46, remanded on other grounds sub nom. SCM Corp. v. FTC, 565 F.2d 807 (2d Cir. 1977). Nevertheless, the Commission has approved Section 8 consent orders which exempt interlocks from reporting requirements in situations where the competitive interface was de minimis. See, e.g., Kraftco Corp., 88 F.T.C. 362 (1976) (directors required to report potential interlocks only if competing sales exceed $1,000,000); IBM Corp., 89 F.T.C. 91 (1977) (directors required to report only if competing sales exceed either 0.5% of company's most recent annual gross revenues or $5,000,000). Thus, the staff, in exercising its enforcement discretion, does consider whether the competing sales are more than de minimis.

These conflicting and confusing decisions make it difficult for large, diversified corporations to select qualified directors from the relatively limited pool of candidates while at the same time avoiding liability under Section 8. Thus, clearly defined de minimis exemptions would clarify the reach of Section 8 and facilitate the selection of qualified directors while at the same time protecting competition.

Although de minimis exemptions are a much needed reform of the current law, we believe that the Act's proposed safe harbor provisions go too far in one respect: they would

exempt interlocks where two corporations have relatively little competitive overlap in absolute dollar terms but dominate a market in a small geographic area. One could anticipate situations in which the competitive overlap is less than $1,000,000 of each corporation's business, but in which the overlap amounted to a substantial market share and a significant proportion of the business of each company. In such circumstances, we believe Section 8 should continue to apply.4/

We propose dealing with this situation by deleting the "safe harbor" contained in Section 2(c)(2) of the Administration bill -- that which would exempt interlocks between corporations where the amount of products or services sold which compete with one another is less than $1,000,000.5/

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4/ We note that the American Bar Association's Section of Antitrust Law, which supports enactment of a de minimis exemption, rejected a de minimis standard focusing solely on the size of the overlap in relation to the size of the competing firms on the ground that "a small percentage of sales of a large corporation may constitute such a substantial share of a relevant market that concerns about the effect on competition would be raised." American Bar Ass'n, Section of Antitrust Law, Report to the House of Delegates 7 (February 1986) ("ABA Report").

5/ The ABA Report proposed a two-pronged de minimis exemption pursuant to which corporations would not be subject to Section 8 if the sales volume of either corporation of a relevant product or services does not exceed $25

(Continued)

This change would not detract from the bill's salutary objectives. The new jurisdictional threshold would leave corporations of less than $10,000,000 in capital, surplus and undivided profits beyond the reach of Section 8, thus freeing small business from the strictures of Section 8. And the two remaining safe harbor provisions would exempt situations in which the business in which two corporations compete is small in relation to their overall size and in which the competitive overlap is small in relation to the relevant market in which they compete. We see no need, and some disadvantage, to going beyond these changes.

Parent/Subsidiary Interlocks

We have also considered whether the Act should address the problem of parent/subsidiary interlocks. With the proliferation of holding companies and large diversified corporations, the issue of whether a shared director of two corporations with competing subsidiaries constitutes a violation of Section 8 has become one of increasing importance.

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(Continued)

million or if the overlap does not exceed ten percent of a relevant market. ABA Report 5. We regard the $25 million test as far too permissive, particularly as it would apply even to small markets. The ten percent market share standard does not vary substantially from the Administration bill.

Until recently, Section 8 was believed not to apply to interlocking directorates between corporations which do not directly compete with each other, but which have subsidiaries that are competitors. Put another way, the "business" of a parent corporation was viewed as not including the businesses of its subsidiaries and, a fortiori, its associated companies.6/ Recent cases have rejected this clear-cut rule and held that competition between subsidiaries may trigger Section 8 in some circumstances.

In United States v. Cleveland Trust Company, 392 F. Supp. 699 (N.D. Ohio 1974), the court, without specifically holding that Section 8 prohibits board interlocks between parents of competing subsidiaries, noted that:

> "one important commentator . . . [has] expressed the view that in determining whether competition between subsidiaries may be imputed to the parents for purposes of section 8, 'where the major policies of the subsidiaries are dictated by the parents, it would seem that

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6/ In 1966, the court in Paramount Pictures Corp. v. Baldwin-Montrose Chemical Co., 1966 Trade Cas. ¶ 71,678, at 82,065 (S.D.N.Y.), held that subsidiaries should be ignored in determining whether interlocking corporations are "competitors" for purposes of Section 8. The court relied upon a 1953 report by the Federal Trade Commission which stated that Section 8 did not "encompass indirect interlocks." Report of the Federal Trade Commission on Interlocking Directors, H.R. Doc. No. 652, 81st Cong., 2d Sess. 10, 14-15 (1950); accord, 4 J. Von Kalinowski, Antitrust Laws & Trade Regulation ¶ 20.02[3] (1979); Staff of the House Comm. on the Judiciary, 89th Cong., 1st Sess., Report on Interlocks in Corporate Management 26 (Comm. Print 1965).

there is a strong case for holding the directorships unlawful. . . .'"

392 F. Supp. at 712, quoting Kramer, Interlocking Directorships and the Clayton Act After 35 Years, 59 Yale L.J. 1266, 1268 n.11 (1950).

Finding that issues of fact existed for trial, the court denied cross-motions for summary judgment on the Section 8 and other antitrust claims. Thus, the court did not rule on the facts before it, expressly leaving the questions of the nature of control and the significance of such control for resolution at trial. 392 F. Supp. at 712. The court nevertheless suggested that the following would be significant in the control calculus: (1) the government's evidence that the subsidiaries involved were both wholly-owned and "strongly tied to their parents," (2) one director's statement that "he could recall no instance" in which the policy matters of the subsidiary were discussed at the parent's board meetings, and (3) another director's statement that policy questions at the competing subsidiary were "infrequently" considered at its parent's board meetings.

The parent/subsidiary question was addressed again in Kennecott Copper Corp. v. Curtiss-Wright Corp., 584 F.2d 1195 (2d Cir. 1978). The Kennecott litigation arose out of a proxy fight between Kennecott and Curtiss-Wright. Curtiss-Wright acquired 9.9 percent of the outstanding shares of

Kennecott and solicited proxies to obtain a significant minority voice on the board. Kennecott brought suit alleging, inter alia, that (1) Curtiss-Wright's acquisition of Kennecott shares would substantially lessen competition or tend to create a monopoly in fabric filter bags, in violation of Section 7 of the Clayton Act, and (2) Curtiss-Wright's proposal to place a Curtiss-Wright director on the Kennecott board would violate Section 8 of the Clayton Act.

Kennecott and Curtiss-Wright were not themselves competitors. However, Curtiss-Wright owned approximately two-thirds of the common stock of Dorr-Oliver, Inc., which in turn owned about two-thirds of the common stock and all of the preferred stock of National Filter Media Corporation, which manufactured fabric filter bags. Kennecott did not itself produce fabric filter bags, but had recently purchased all the assets of the Carborundum Company, whose Filter Media Division manufactured fabric filter bags. 584 F.2d at 1202-03.

After a bench trial, the district court concluded that the acquisition and the proposed election of a Curtiss-Wright director to the Kennecott board violated Sections 7 and 8 of the Clayton Act. It therefore enjoined Curtiss-Wright from voting its shares and proxies.

The Second Circuit reversed. It remanded the Section 7 claims for a new trial. But it dismissed the Section 8

claim on the evidence presented at the first trial. The Court of Appeals declined to lay down a blanket rule, as the district court had done, "that section 8 prohibits interlocking directorships between parent companies whose subsidiaries are competitors." 584 F.2d at 1205. Such a general rule, the Court of Appeals held, "is not supported by the language of the statute, its legislative history, or the few pertinent cases." Id. (footnote omitted). However, implying that Section 8 in certain circumstances might encompass parents whose subsidiaries compete, the Court went on to state, in pertinent part:

> "We need not conjecture about the possible application of the statute to a parent corporation that closely controls and dictates the policies of its subsidiary. See United States v. Cleveland Trust Co., supra, 392 F. Supp. at 712. Here, the proof is undisputed that no one from Curtiss-Wright or from its subsidiary, Dorr-Oliver, has ever told Dorr-Oliver's subsidiary, National Filter, how to run its business." 584 F.2d at 1205.

The short shrift that the Court of Appeals gave the control argument on the facts before it provides little guidance in predicting how the courts will analyze the problem in the future.

The most recent judicial examination of the parent/subsidiary question occurred in United States v. Crocker National Corporation, 656 F.2d 428 (9th Cir. 1981), rev'd on other grounds sub nom. Bankamerica Corp. v. United States, 462 U.S. 122 (1983). The court there held, inter alia, that

the business of bank holding companies included the business of their closely controlled subsidiary banks for purposes of Section 8. Like the Kennecott court, the court in Crocker refused to adopt a broad rule that the businesses of subsidiary corporations are always attributable to their parents. Instead, the court adopted the control test of Cleveland Trust:

> "If the parent substantially controls the policies of its subsidiary, it may fairly be said, in the language of the competing corporations provisions of Section 8, that the 'business and location' of the parent include the business and location of the subsidiary." Id. at 450.

Again, the court provided little guidance for applying this test, concluding that the parties' stipulations and the banking statutes established as a matter of law that the bank holding companies substantially controlled their subsidiary banks.

In the single FTC decision dealing with the parent/subsidiary problem, Borg-Warner Corp., 101 F.T.C. 863 (1983), rev'd on other grounds, 746 F.2d 108 (2d Cir. 1984), the Commission held that Section 8 does apply to interlocked parents that assert sufficient control over competing subsidiaries. After a detailed analysis of the facts, the Commission held that Robert Bosch GmbH, a West German corporation, exercised sufficient control over its American subsidiary, Robert Bosch Corporation to be considered a

"competitor" of Borg-Warner Corporation in the sale of certain automobile parts in the United States. The Commission did not, however, present any checklist of factors by which to measure whether the parent's control of the subsidiary was sufficient to make a common director at the parent level an impermissible interlock.

The cases illustrate the fact that corporations are subject to uncertainty in assessing the legality of parent/subsidiary interlocks. The "5 percent" safe harbor in the proposed amendment can be expected to eliminate this uncertainty in a fair number of cases. In any event, the issues surrounding indirect interlocks are quite complex, extending beyond the parent/subsidiary situation, and we agree with the ABA that this area is best left to develop on a case-by-case basis. See ABA Report 3.

## Conclusion

The Interlocking Directorates Act of 1986 would provide much needed and long-overdue reform of section 8 of the Clayton Act. The jurisdictional threshold of $1,000,000, which was first instituted in 1914, does not adequately reflect the size of the modern corporation or modern economy. In today's market a corporation having capital and surplus of $1,000,000 no longer has a substantial impact on competition or prices. In addition, indexing the jurisdictional threshold

will ensure that it adequately reflects the growth of corporations and the economy.

Further, the Act's safe harbor provisions would clarify Section 8's scope and make it easier for corporations to select qualified directors while at the same time protecting the public from dampening of competition and price manipulation. The Act's safe harbor provisions, however, are unduly permissive in allowing interlocks among corporations whose competitive overlap is small in absolute terms but large in relation to a small geographic market. Interlocking directorates in such a case could prove a threat to competition. Accordingly, we support the bill provided Section 2(c)(2) is deleted.

Committee on Antitrust and Trade Regulation

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New York, New York

Statement of R. Allan Leedy, Jr.
Vice President, Secretary, and General Counsel
TEKTRONIX, INC.

Before the Committee on the Judiciary
United States Senate, Washington, D.C.

April 28, 1986

Mr. Chairman and Members of the Committee. I am R. Allan Leedy, vice president, secretary, and general counsel of Tektronix, Inc. Tektronix is a leading manufacturer of high-technology capital equipment for electronics research, development, manufacturing and services uses, with annual sales of about $1.5-billion and about 20,000 employees world-wide. On behalf of Tektronix, I appreciate this opportunity to testify in support of S. 2163, the Interlocking Directorates Act of 1986, and other proposals to revise Section 8 of the Clayton Act.

American industrial companies face real and growing needs for qualified individuals to serve as directors. Pressures in this direction come not only from the law and from institutions that regulate and oversee corporate activity, but also from the increasing effects of foreign competition directed more and more at the most successful and profitable American companies, including Tektronix.

While need for qualified corporate directors has intensified, directors have been held by Federal legislation, regulatory agencies and the courts to ever more exacting standards of responsibility and performance. Today's corporate directors are exposed to risks of personal liability that have grown dramatically in recent years. These new demands and concerns are a double constraint on the pool of available individuals. They discourage the qualified while posing still higher standards of qualification.

As this Committee is well aware, Section 8 of the Clayton Act prohibits an individual from serving as a director of two companies engaged in interstate commerce if the companies are competitors. As interpreted by the courts and the Federal Trade Commission, the Section 8 prohibition is a per se rule of law that bars director "interlocks" without regard to the economic significance of the competition that may exist between the two companies.

Mr. Chairman and Members of the Committee, Tektronix challenges the premise that director interlocks are undesirable per se, without regard to the degree of competition between the companies involved. We find little factual support in the literature and our own experience for outdated assertions of the evils associated with director interlocks. We have, in fact, come to the contrary view: that director interlocks, even where there is some degree of competition, may produce benefits that significantly outweigh the potential dangers or abuses addressed by Section 8. Far from lessening competition, such interlocks may, in fact, be expected to increase the competitiveness of U.S. industrial companies where it now really matters -- in facing foreign competitors in markets both at home and abroad.

Section 8 of the Clayton Act, in its present form, too often operates to disqualify as director candidates those individuals who offer relevant experience and expertise, simply because relevance frequently implies some degree of competitive overlap. As industrial firms become more diversified and adopt new technologies, the problem intensifies. For example, companies as diverse as General Motors and General Electric have business activities that compete with parts of Tektronix, so that Tektronix would be prohibited from having interlocking directors with either. Yet these companies are not competitors of Tektronix in any sense that has economic significance in their respective markets. Moreover, the companies that represent the most direct competition for these U.S. concerns (Nissan and Toyota, for example, for General Motors; Hitachi and Matsushita, for example, for Tektronix) are not subject to similar legislative constraints. Rather, it is increasingly understood and accepted that these Japanese companies operate in an environment that fosters and promotes the sharing of business and technical expertise among competing companies.

As a company, we have reached these conclusions on the basis of actual experience, and the Committee may be interested in our example. We embarked about a year ago upon a program to identify candidates to replace one or two of our outside directors who were approaching retirement. (The company has 10 directors, out of a total of 11, who are not on the payroll as employees or executives). As part of this process, a nominating committee was designated; it deliberated and identified certain areas of expertise that it felt were needed on our board of directors. Relevant expertise in manufacturing technology and productivity topped the list of needs. This was no accident since our company was at the time, and still is, in the midst of a significant program of investment and change aimed at enabling us to match the productivity and manufacturing efficiency of our competition which, as I have mentioned, comes increasingly from Japan.

Having engaged the services of an outside consultant, we identified companies from whom director candidates might be sought who could fulfill our need for relevant manufacturing experience. As a second step, we subjected those companies, and some individual names, to a Section 8 competition analysis. We quickly concluded, because of the wide-ranging nature of our business and the frequency with which minor areas of competitive overlap arise, that virtually all the companies we were able to identify as utilizing relevant manufacturing technologies were companies whose directors were disqualified by Section 8 from serving on our board. As a consequence, we were obliged to abandon this particular objective, and to look elsewhere for director candidates.

* * *

As a practical solution to the problem I have been describing, Mr. Chairman, Tektronix respectfully proposes establishing in Section 8 a "rule of reason" test for director interlocks. The specific language amending Section 8 we are suggesting is appended to my testimony. Under this proposal, director interlocks between two companies would not be prohibited unless a merger or combination of those two companies would unreasonably restrain trade. In short, the tests under Section 7 for mergers would become the "rule of reason" standards for director interlocks. If firms could merge or combine under Section 7, why should they be barred from having directors in common under Section 8?

We believe this approach would actually foster meaningful competition as well as a number of related social aims, with little or no increase in administrative burden. Director interlocks will not in themselves necessarily produce anticompetitive behavior, since the substantive constraints of the antitrust laws would continue to apply to limit such conduct. Individuals representing competing companies as directors would be subject (as all directors are) to requirements of loyalty to each such company and of avoiding self-dealing and conflicts of interest. These requirements would operate as strong constraints on anticompetitive behavior.

Mr. Chairman, S. 2163, the Administration proposal, and a similar proposal by the American bar association that would establish de minimis exceptions to the Section 8 prohibitions, improve the current state of the law by removing the harsh effects from extremely minor competitive overlaps. We believe the Administration's proposal goes some distance in the direction of meeting the aims that are addressed by our own proposal, but it does not do the job entirely, especially in view of the relatively modest combined market share that the three-percent "safe harbor" in the Administration's proposal would permit. It is difficult to assess the likely benefits of the "safe harbor" approach, but certainly the more liberal ten-percent combined market share standard endorsed by the American Bar Association would be more helpful.

Regardless of the numbers, however, the Administration and American Bar Association proposals reflect the premise that director interlocks are inherently evil and wrong, and merely carve out an area defined as being inconsequential. The Tektronix proposal is based upon what we consider the more realistic premise that in the current climate of global competition interlocks can actually contribute to competition. It requires case-by-case evaluation of whether, when competition exists, a particular

interlock would be unreasonable, thereby preserving a useful element of subjectivity in the statute as to just which interlocking directorships might enhance competition, and which might constrain it.

Although Tektronix considers the arguments strong for a "rule of reason" approach alone, it might be desirable to combine that approach with defined "safe harbors." In a combined approach, certain interlocks, within the safe harbors and below the de minimis threshold, would be lawful per se, and interlocks not meeting those tests would be eligible for "rule of reason" analysis.

Mr. Chairman, the President's Advisory Committee on Industrial Innovation, in its 1979 Final Report, stated: "The American market has increasingly become part of an international market. . . . Antitrust policies have been slow to recognize the extent and significance of this development, and particularly the relative erosion of American technical and cost leadership." It noted that "Antitrust policies which discourage innovation are, to that extent, inherently anticompetitive," and recommended that action be taken "to reduce the deterrent effect of antitrust upon innovation-related decisions where no genuine anticompetitive threat exists . . . ."

Those conclusions certainly ring true for Tektronix and, I believe, for high-tech industries as a whole. We need the best available expertise and technology in all phases of our business to innovate and compete. Obviously, there are many ways besides the election of outside directors for Tektronix and other firms to search out and tap the kinds of experience and expertise we seek. But opening the door for qualified candidates to serve as directors, notwithstanding certain competitive overlaps, would remove a major obstacle to the sharing of American industrial expertise and technology that is essential to our continued competitiveness.

I thank the Committee for this opportunity to testify and for conducting these important hearings.

AMENDMENT TO CLAYTON ACT SECTION 8 (15 U.S.C. SECTION 19)

PROPOSED BY TEKTRONIX, INC.

"No person at the same time shall be a director in any two or more corporations, any one of which has capital, surplus, and undivided profits aggregating more than $1,000,000, engaged in whole or part in commerce, . . . if such corporations are or shall have been theretofore, by virtue of their business and location, competitors, so that ~~the elimination of competition by agreement between them would constitute a violation of any of the provisions of any of the antitrust laws~~ a merger, acquisition or combination involving such corporations would substantially lessen competition or tend to create a monopoly."

Statement of The Business Roundtable on
S. 2163 - The Interlocking Directorate Act of 1986

My name is John D. Ong. I am Chairman of the BFGoodrich Company. I submit this statement on behalf of The Business Roundtable, whose Antitrust and Government Regulation Task Force I chair. The composition of the Roundtable and the reasons for its interest in antitrust legislation were set forth in my statement of April 15 on S.1300 and S.2162. The Roundtable supports the Interlocking Directorate Act of 1986, S.2163, which would establish reasonable de minimis exceptions to the flat prohibition on director interlocks contained in Section 8 of the Clayton Act, 15 U.S.C. § 19.

Support for some amendment to Section 8 is general, diverse, and widespread. I am informed that many people who consider other antitrust reform proposals to be controversial agree with the changes embodied in S.2163.

The amendment of Section 8 will not only remove a burdensome anomaly in the antitrust laws; it will also promote better corporate governance. In the past ten years, there has been a surge of concern about the responsibilities and structure of corporate boards of directors. In 1978, the Roundtable proposed that "in most instances . . . it is desirable that the board be composed of a majority of

non-management directors." 1/ Most commentators agree that outside directors are essential to insure objective review of management performance and to focus on long-range corporate interests. 2/

Despite the general recognition that it is important to have strong outside directors, however, it is becoming increasingly difficult to find capable, qualified people to serve as corporate directors. One factor has been the increased exposure of corporate directors to potential liability claims and the consequent increased cost or unavailability of liability insurance. But Section 8 also raises significant obstacles to the election of qualified outside directors.

In its present form, Section 8 contains an absolute prohibition on a person serving as a director of two corporations that compete in any way if either has capital,

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1/ Statement of The Business Roundtable, The Role and Composition of the Board of Directors of the Large Publicly Held Corporation, reprinted in 33 Bus. Law. 2083, 2108 (1978).

2/ See, e.g., American Bar Ass'n, Corporate Director's Guidebook, reprinted in 33 Bus. Law. 1591, 1619-27 (1978); American Law Institute, Principles of Corporate Governance § 3.04 (Tentative Draft No. 2, April 13, 1984). The New York Stock Exchange and American Stock Exchange require a minimum of two independent directors. The New York Stock Exchange also requires that the audit committee of a board of directors be comprised of outside directors. Securities Act Release No. 13,346.

surplus, or profits in excess of $1 million. This jurisdictional threshold has not been changed since 1914, when a dollar was worth about ten times what it is today, and it now applies to corporations that are far too small to be the objects of special antitrust concern. Moreover, Section 8 applies regardless of how insignificant competition between the companies may be. 3/ The companies are deemed to be competitors even if they sell to different kinds of direct customers, 4/ so they must determine whether products they produce conceivably compete at any level. There is no "safe harbor" in the present law; companies that compete at any level or to any degree cannot share a common director.

As a result, Section 8 has created an antitrust compliance nightmare for major corporations, especially corporations engaged in diverse business activities. It is very difficult to determine whether there is any competition at any level between two companies. A review of publicly available information may not reveal minimal competition, and even a company's own marketing people do not necessarily know who all their competitors are at various levels of

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3/ TRW, Inc. v. FTC, 647 F.2d 942, 948 (9th Cir. 1981); In the Matter of Borg-Warner Corp., 102 F.T.C. 1164 (1983), rev'd on other grounds sub nom. Borg-Warner Corp. v. Federal Trade Commission, 746 F.2d 108 (2d Cir. 1984).

4/ See FTC decision in Borg-Warner, supra.

distribution. Moreover, none of this information is static. Corporations often enter new areas of business activity that may create a prohibited interlock where none previously existed. Even worse, a corporation may be considering entry into a new line of business, and would not want that information to become public or known to potential competitors. It is not hard to imagine the problems faced by counsel responsible for antitrust compliance, when they attempt to inquire about facts of this kind in order to properly advise director candidates or a corporation. The safest thing to do is to consider only candidates who are engaged in businesses that are totally remote, but such people are not always the best candidates for outside directorships.

It is no answer to say that Section 8 provides for a year of grace to uncover and fix problems or that corporations involved in prohibited interlocks may not be liable for treble damages. 5/ Corporations are subject to enforcement actions by the Department of Justice and the Federal Trade Commission, as well as private injunctive actions. Even if the director resigns, there is likely to be expensive litigation and a consent decree that allows the government to monitor director selection procedures and imposes reporting requirements on the

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5/ There do not appear to be any cases imposing treble damage liability for a violation of Section 8.

companies involved. Moreover, it is genuinely embarrassing when a director, who is likely to be a prominent member of the business community, has to resign for reasons that may appear to suggest impropriety.

These problems will be considerably eased by passage of S.2163, which would establish a safe harbor for de minimis competitive overlaps, but preserve the prohibition against interlocks between companies that compete in a substantial way. We recognize that a safe harbor does not always operate entirely automatically because the calculation of shares of sales requires judgment, but at least counsel know genuinely insignificant competitive overlaps will not trigger the statute.

It is important to remember that Section 8 reform will not give anyone a license to enter into anticompetitive agreements that otherwise violate the antitrust laws. Agreements to fix prices, for example, will still violate Section 1 of the Sherman Act, however small the affected sales may be. S.2163 recognizes that it is not necessary to have another special line of defense when the companies or shares of sales are relatively small. S.2163 is also based on a realistic recognition of the way corporate boards work. Competitive strategies that affect an insignificant segment of a corporation's business simply do not surface at the director level. Moreover, companies do not want directors who also serve as directors of real competitors. Finally, you have to

give corporate directors some credit for common sense. For example, they are constantly alert for conflict-of-interest problems, such as contracts with firms in which they have an investment interest, that have nothing to do with antitrust, and you cannot draft per se prohibitons to cover all of these things without destroying the viability of independent boards of directors.

In summary, S. 2163 would neither hamper antitrust enforcement nor raise any real dangers of competitive injury. It would vastly simplify the lives of corporate counsel and facilitate the selection of the best qualified outside corporate directors. This is in everyone's interest. For these reasons the Business Roundtable supports S.2163, the Interlocking Directorate Act of 1986.